AN ECONOMIST'S PROTEST

AN ECONOMIST'S PROTEST

BY

EDWIN CANNAN
EMERITUS PROFESSOR OF POLITICAL ECONOMY
IN THE UNIVERSITY OF LONDON

LONDON
P. S. KING & SON, LTD.
ORCHARD HOUSE, WESTMINSTER
1927

PRINTED IN GREAT BRITAIN

PREFACE

What should I answer if anyone had the impertinence to ask me, " What did you do in the Great War ? " It would be no use to say that immediately on the outbreak I offered my services as a harvester, for the young man who took my name evidently regarded me as far too old (at 53, thirteen long years ago !), and nothing ever came of it. It would be no better to say that I sat for quite a long time on several committees, because everyone did, and nothing ever came of that. The best answer I can think of is " I protested."

Hence the title of this book, which consists of a selection from a considerably larger number of letters and articles, published and unpublished, which I wrote from 1914 to 1926. I have left them almost exactly in chronological order instead of re-arranging them under subject headings, because I think that they have running through them only two main lines of protest, the one against what may be called economic nationalism or nationalist economics, and the other against expedients which ought to be rejected whether the economic ideal aimed at is nationalist or cosmopolitan. And these two are so intertwined that it is undesirable to try to keep them apart. Even the choice and management of a national currency is inextricably mixed up with international relations.

I had long been a protestant against the current identification of " the country " or " the nation " (that is, the country or the nation of the speaker or writer) with the economic " society " or " community." Readers of the *Economic Outlook* with retentive memories may recall that in 1908 I valiantly tried to persuade the Irish not to lament over the depopulation of Ireland,

and that in 1909, equally valiantly and equally vainly, I tried to persuade the Socialists to give up imagining that they can safely aim at the internal re-organization of each of the existing nations separately, and ignore the greater Society which includes them all. In *Wealth*, published seven months before the beginning of the War, as well as long before in my oral teaching of economics and public finance I had always tried to be a mundane rather than a national economist. I refused to pretend to think of each and every nation in turn as of an honest and law-abiding householder surrounded by burglars and murderers against whom he had to arrange and pay for "defence," so that military and naval exertions of all nations and all times were just as legitimate and productive industry as that of the medical profession, which does its best to defend us against the attacks of disease. I had even complained that although it was no longer thought right to eat the foreigner or even to reduce him to slavery, it was generally thought quite legitimate to tax him (if possible) and to prevent him immigrating to improve his condition, even when it was admitted that to obstruct his movement was contrary to the good of the world as a whole. Patriotism, I thought, like the egotism of which it is a larger variety, was an excellent thing only when kept within certain bounds by appropriate institutions. Still later, in May, 1914, I tried to show in the first article reprinted in the present collection that no permanent benefit could be won for the pure working class of any particular nation by the most successful war.

I had also been an almost life-long protestant against the shallow habit—by no means confined to professed socialists—of proposing remedies for economic pressure without considering the question whether that pressure may not be an integral part of the existing organization which cannot be removed without causing disaster unless some efficient substitute is provided. Modern civilization, nearly all civilization, is based on the principle of making things pleasant for those who please

the market and unpleasant for those who fail to do so, and whatever defects this principle may have, it is better than none. Illustration will be found in the second of the two pre-war articles below, where I complain that the Liberal "Land Enquiry Committee" proposed to do away with one of the principal regulators of the distribution of population without the least suggestion of putting anything else in its place.

Inter arma silent leges, as I remark below in 1915 IX, is not to be translated "In time of war economic laws don't work," and though, as I suggest there, it may sometimes be well to be silent about some of them, this is not the general rule. The outbreak of the World War in August, 1914, called for not less but more vigour in the two lines of protest which I have indicated. That catastrophe made it painfully evident that the system of entirely independent states each with its own politicians and economists regarding it as Society at large and treating the interest of all outside it as of no account had become not only inconvenient, but absolutely incompatible with the continuance of civilization. It became very widely acknowledged that there must be some cosmopolitan organization and authority to settle international disputes and prevent recourse to international violence just as there is in each country a national organization and authority to settle individual disputes and prevent individual recourse to violence.

At first I had only to do my best to support this change of opinion. I did so by pointing out (as in the articles 1915 III and 1916 IV) that the supposed "economic" causes of war, when carefully analysed, turn out to be at bottom the result not of economic incompatibilities but of strategic jealousies and alarms. When these are exorcised by the disappearance of separate military forces and consequently of the possibility of war, nationalism becomes contented with home rule, and loses the bitterness usually given to it by fear.

But war, as Adam Smith said of a more respectable trade, is "a brutal and an odious business." Under its malign influence the noble aspirations with which

the Great War opened soon wilted away: particularist and anti-social nationalisms revived, and all the "mean and malignant expedients" of mercantilism were resuscitated for use not only against enemies in the field but also for permanent employment against both quondam enemies and quondam allies after peace was made. My attitude of protest had to be resumed, and many of the items, from 1916 I, "Mercantile war to follow military war?" down to 1923 II, "Professors and Protection," are attempts to stem this reaction to ideas and methods rightly discarded in the more peaceful atmosphere of the nineteenth century.

Some friends of peace and goodwill for whom I had the highest respect took a very gloomy view of the probable results of a complete defeat of the Central Powers. In spite of all my dissatisfaction with war propaganda and its effects on public opinion, I was more cheerful, and endeavoured to show in "A Plea for Large Political Units" (1916 VII) that there was a probability of the confederates against the Central Powers becoming in the end the nucleus of a more comprehensive federation which would include the defeated powers. Now, in 1927, when we have seen the Locarno Pact and the admission of Germany to the Council of the League of Nations, it looks as if perhaps I was not far wrong.

With this idea in my mind I could do my best to help in the war without being oppressed, as many good men and women were, with the sickening thought that it was all to no purpose and possibly actually harmful. I made various practical suggestions of a positive kind, some of which were adopted (I do not say in consequence of my recommendation). But the greater part of my effort was directed to combating some extraordinary delusions which took possession of the minds of the people and their governors.

The earliest of these was the idea that there was danger of unemployment unless everyone continued to spend as before. This gave rise to what I have called the first war slogan, "Business as Usual" (see 1914 III).

It was short-lived, and soon gave way before a much more dangerous delusion, the belief that everything ought to be sold at the same price as before the war, and that anyone who sold anything at a higher price than that was an extortioner of so deep a dye that a new word, "profiteer," had to be invented for him. Regulation of prices, with the intention of keeping them down, began to be undertaken by the Government, and this of course soon led to what became known as the queue system of distribution; when there was a shortage of the supply of any article and the price was prevented from rising by regulation, so that the demand was not contracted as usual by a rise of price, the would-be buyers stood in a queue for the commodity in question, and those at the head of the queue got as much as they wanted, and those at the other end got none. The course of things showed a complete absence of any general appreciation of the function of prices. Hence the appearance in this collection of many protests, of which the most general is 1915 II, "Why some prices should rise," or as it was originally entitled, "The Good Side of Rising Prices."

The rise of prices which I defended was of course the rise in the price of particular things which happened to be in abnormally short supply or for which there happened to be an abnormally large demand. But it was not long before a different kind of rise of price, little thought of at first, the general rise of prices which is synonymous with decline in the purchasing power of money, began to force itself on the attention of the public.

Part of the depreciation of the pound merely corresponded with a depreciation of gold throughout the world. Some hoards had been or were being thrown on the market, and the usual demand of the mints for currency purposes was entirely cut off, while the production of gold proceeded with little diminution. The natural result was that an ounce of gold would buy less than formerly. Great Britain might, of course, by sufficient limitation of the issue of paper money and

closing the Mint and the Bank of England against the reception of gold, have kept the purchasing power of the pound above that of the old gold equivalent of a pound (123¼ grains of standard or 113 of pure gold). That would have prevented the rise of prices with all its attendant troubles, and have reduced the nominal cost of the war enormously and the real cost substantially though not nearly so much. But it would have given rise to considerable difficulties after the war, and in fact nobody asked for it.

All that could be reasonably expected was that the pound should not be reduced in value below its gold equivalent.

To the veteran Professor Shield Nicholson belongs the credit of scenting danger in the Currency Note issue as early as the first month of the War. In the *Scotsman* of August 18, 1914, he suggested that the notes might become inconvertible, and that if prices came to be measured in inconvertible notes, there would be no limit to the rise of prices except in the moderation of the authority issuing the notes (*War Finance*, 1917, p. 179). But most of us were lulled to sleep by the promise of the Currency and Bank Notes Act, 1914, that the notes should be convertible into gold coin at the Bank of England. We forgot, if we ever knew, that Ricardo, a hundred years before, had observed that gold coin which could not be melted or exported could be depreciated below the value of its weight in free bullion to a level set by the paper currency. I think I only began to be suspicious in 1916 and alarmed in 1917.

Late as this was, it was early if measured by the progress of general opinion on the subject. It is almost incredible now, but it is a fact that everywhere most of those who were regarded by the public as monetary experts refused to believe that the paper issues of their own particular country had anything to do with the rise of prices in that country. The usual line taken was to allege that the large additions to the paper currency were the effect and not the cause of the rise. The fact was never faced that under the pre-war gold

standard this doctrine would have appeared palpably absurd. Before the War it had become quite well accepted in expert circles that the rise of prices which had taken place since the nineties was due to the large amount of gold forthcoming from the Transvaal: no one had ever thought of suggesting that the rise of prices had called forth the gold from the mines in the mysterious way in which it was now supposed that the rise of prices was calling forth currency notes from the press.

Of the few experts who admitted that the issue of paper money had been the cause of the rise of prices many were angry with anyone who ventured to deprecate it, because, they said, the issue was necessary to finance the enormous expense of the War. They completely overlooked the fact that this enormous expense measured in money was largely due to the depreciation of money, and that if money had not depreciated, it would not have been nearly so large.

By 1918 I was thoroughly aroused, and in August of that year I found some distraction from a recent almost overwhelming private sorrow in devoting a strenuous month's work to writing the first edition of *Money: its connexion with rising and falling prices*, an elementary exposition of which the oft-recurring refrain is, "to maintain the value of a currency due limitation of issue is necessary." My publishers, rather to my surprise at that very difficult time, took the work in hand at once and it came out at Christmas. My sanguine hopes that it might make some difference were, lik most authors' hopes, disappointed, and to my infinit disgust, the issue which had been defended as nec sary to carry on the war continued on its course at nearly as rapid a rate after the Armis before it.

I continued protesting all through 1919, a at the proposal of my publishers, suggeste by Mr. Samuel Evans, that I should edi the Bullion Report of 1810. This appea under the title of *The Paper Pound of*

title which was intended to help, and I think did help a little, to make people think of the pound of 1914–25 as a paper pound. But a more powerful engine was set to work about the same time. In October I had grumbled to a member of the Cunliffe Committee about its inaction, and he admitted that it had "been in a trance for a long time," but said it was just going to meet again. It did so, and soon produced the Report recommending what became known as "the Cunliffe limit" on the issue of Currency Notes, and this was adopted by the Government in the Treasury Minute of December 15.

The battle, however, scarcely appeared to be won. If the limit held, the currency could not be increased unless its old par with gold was first restored, but there was nothing to show that the existing currency would be reduced in amount so as to bring that restoration about in the early future. Moreover there was no security that the Treasury Minute, made by one Chancellor of the Exchequer, might not be varied by another Minute, made by the same or a subsequent Chancellor. The idea that the limit would hold was openly derided by many of the foremost experts, and their contempt for it seemed to be justified by the fact that during the months from March to July the fiduciary issue of Currency Notes rose faster and to higher level than it had done in the corresponding months of 1919, terrifying the Treasury into the very pusillanimous action of ractically enlarging the limit by declaring a few millions notes forming the earliest issue to be "called in but t yet cancelled," and therefore not to be reckoned art of the total outstanding. In the same period vas also a considerable increase in the Bank of l notes outstanding.

ppearances were deceptive. The increase of England notes was more than accounted for ct that some were being locked away against Notes, which only meant that the public were £5 notes for £1 notes, and others were being banks in exchange for gold coin surrendered

at par to the Bank of England. The banks did not lend out these notes any more than they had lent out the stocks of sovereigns and half-sovereigns which they had held in reserve since the early days of the War. Whether they thought the Cunliffe limit would hold or not, they were cautious enough to assume that it would, and to act on that assumption with the effect of causing bitter complaint by borrowers who still foolishly wanted to borrow on the assumption that prices would go on increasing. The adoption of the Cunliffe limit by the Treasury did in fact stop the handing out of additional currency to the public from December, 1919, and stopped the rise of prices from the following April.

I had been ridiculed by some experts for saying in the preface to the *Paper Pound*, " When the scales at last fall from the eyes of the people of Europe, groaning under the rise of prices, they will no longer cry to their governments 'Hang the profiteers!' but 'Burn your paper money, and go on burning it till it will buy as much gold as it used to do!' " The people remained blind, but after keeping the total currency in the hands of the public nearly stationary throughout 1920, the Treasury got in (by taxation and borrowing) sixty-six millions of Currency Notes and burnt them, reducing the amount outstanding from the top point of £367,600,000 to £301,300,000. The total currency outstanding was further reduced by eight millions in Bank of England notes and at least seven millions in silver coin withdrawn from circulation. In the two years from March, 1920, to March, 1923, the pound rose from 70 to 96 per cent. of its par gold value.

As the articles numbered 1920 IX and 1921 III show, I saw little reason to complain of this policy, but sometime in 1923 it was dropped in favour of the " wait and see " policy of keeping the amount of currency stationary and hoping that restoration of the paper pound to gold par would be brought about by a fall in the value of gold. In the winter of 1923–4 the Macdonald Labour Government took office, and the article

1924 III was produced in the course of an effort to encourage it to resist the demands of the inflationists, big and "little." Fortunately the Government recognized that the wage-earners always stand to lose by rise of prices. It stood firm, and after two years' unnecessary delay the waiting policy justified itself, and the gold standard was restored by Mr. Baldwin's second government in April, 1925.

Meanwhile the relaxation of tension in this country allowed me to give some attention to South African, German, and French monetary conditions (1920 X, 1923 III and IV, 1924 I and 1925 I) besides dealing with a number of questions in monetary theory of general rather than immediate political interest. Articles on these subjects will be found scattered through 1920 to 1925. And as the European monetary situation slowly cleared up when the nations, one by one, found it easy enough to restore gold when they had once made up their mind to do so, a return of old and more general interests is observable, and the book ends with a lecture which, though delivered in my penultimate term, may be regarded as my valediction to the London School of Economics and a restatement of my belief in the gospel of mutual service not only as between persons inside each country, but also between the people of every country and every colour.

Those of the articles which are reprints were indebted for their original appearance to eighteen different publications, the names of which are duly noted at the heads of each article. Here I need only express my best thanks to all for their aid to my protest, and to the *Economic Journal*, the *Journal of the Royal Statistical Society*, the *Contemporary Review*, *The Times*, the *Manchester Guardian*, and the *Daily Mail*, for the kindly-given permissions to reprint which it was necessary to obtain from them.

I have corrected a few obvious slips of the pen and misprints, such as "creditor" for "debtor" and the omission of "not," and faults of expression such as "provide the want" for "satisfy the want," but other-

wise *litera scripta manet*—I have resisted all temptations to try to amend the articles, whether previously published or not. When I have suppressed the names of correspondents and others it is because I have feared that they might dislike either the publicity or my version, explicit or implied, of their views.

OXFORD.
June, 1927.

CONTENTS

1914

CHAP.		PAGE
I	The Cosmopolitan Interest of Labour	1
II	Housing Before the War	5
III	The First War Slogan: "Business as Usual!"	11
IV	Labour is not a Curse nor even a Cost	14

1915

I	"Hurry Up Public Expenditure?"	15
II	Why some Prices should Rise	16
III	Strategic Jealousies masked as Commercial	26
IV	Against Coal Control	29
V	Why the Institution of Property is Maintained	35
VI	Against a Subsidy for Home-grown Wheat	42
VII	Can Capital be "Realized" to Pay for the War?	44
VIII	How to get Contributions from Small Savers	46
IX	How to Argue against Ca' Canny	48
X	Which shall we have? Real Peace, or a Sacrifice of Everything to Preparation for the Next War?	49

1916

I	Mercantile War to succeed Military War?	54
II	An Apology for the Excess Profits Tax	62
III	A Labour-saving Suggestion Politely Received	64
IV	International Anarchy from an Economic Point of View	65
V	What is Wealth? Fighters and Munition-Workers?	77
VI	War and Population	79
VII	A Plea for Large Political Units	83
VIII	Trade and War. The Cause or the Cure?	88
IX	What the Committee on Prices might have Done: and What it Did	91

1917

CHAP.		PAGE
I	Opening of the Campaign against Inflation	107
II	The Influence of the War on Commercial Policy	120
III	The Causes of Discontent	133
IV	History Repeats Itself	152

1918

I	Why the War costs so much	156
II	Will Labour give the Go-by to the State?	162
III	Labour versus Capital, or Debtor versus Creditor?	164
IV	"We had Butter: A Beneficent State has given us Margarine"	166
V	Should National Debts be Enforced?	168

1919

I	"The War has made many a Happy Home"	178
II	The alleged Failure of Profit-making	184
III	Currency on the Eve of the Cunliffe Limitation	186
IV	An Attempt at Popular Propaganda: "Prosecute the Chancellor of the Exchequer for Profiteering!" 2. Why Things are Dear	195
V	Letters accompanying Presentation Copies of *The Paper Pound of* 1797–1821	199

1920

I	How Additional Currency is put on the Market	205
II	What is the true Purpose of a Rise of Bank Rate?	208
III	Schemes for building Houses without having to Pay for Them	210
IV	Another attempt at Popularization: Paper Money and Prices	212
V	Very close Correspondence between Currency and Prices not to be Expected	218
VI	The Usual and Most Convenient Meaning of Inflation	221
VII	Banks and their Depositors not to be Blamed for the Inflation	224
VIII	A Return to Gold Easier than is Supposed, as well as Desirable	226
IX	"Things are Going Well: Lie Low and say Nuffin'"	229
X	South Africa's True Interest: and the Theory of Foreign Exchange. 1. South Africa's Interest in the continued Use of Gold Money. 2. South Africa made the Victim of Foreign Exchange Delusions	231

CHAP.		PAGE
XI	Orthodox and other Principles for the Regulation of Wages	250
XII	Better be a Bankrupt than a False Coiner	252
XIII	Some Fall of Prices is Desirable	253

1921

I	The Difference between a Bank and a Cloak-room	256
II	Fundamentals in Regard to Wealth and Taxation	266
III	Deflation making Progress: Good Effect of Bills by Tender instead of Bills on Tap	280
IV	What the War-Bond Holder can Justly Claim	283
V	The Deflation of 1815–21: Comparison with the Present	283
VI	The Determination of the Rate of Interest	285
VII	Don't Grouse!	298

1922

I	What Level of Prices should be Aimed At; and some Historical Questions	299
II	Gold for Currency or only for Standard?	307
III	Taxable Capacity: and the Burden of Debt	309
IV	Cost, Rent, "Waiting," and Supply and Demand	311
V	Booms	315
VI	How Much can we profitably induce Germany to Pay?	320
VII	"A Right Discount Policy" Ineffective against Excessive Inconvertible Paper	323

1923

I	Adam Smith on Twentieth-Century Finance	335
II	Professors and Protection	341
III	The Gold Mark will be Restored	347
IV	Good Money drives out Bad in the Long Run: but why not Quicker?	348
V	The Payments which have to be made determine the Balance of Trade	351
VI	Are Currency Notes "Arbitrarily Limited" or "Automatically Regulated"?	352
VII	Exchange Stability, or Price Stability? Keynes' Choice	354

1924

CHAP.		PAGE
I	Don't Decry the Rentenmark!	359
II	"Borrowing from Banks"; when Pernicious	362
III	Observations on the present Currency Situation (Feb. 6, 1924)	363
IV	The Cheque Stamp tends to keep up the Value of Currency	369
V	Limitation of Currency, or Limitation of Credit?	370
VI	Recent Improvements in Monetary Theory	384

1925

I	*Déflation en pratique et Déflation pour rire*	392
II	"Increased Purchasing Power" and Employment	397
III	Knapp's Bubble	398
IV	The British Gold Standard Restored	403
V	More Elementary Economics Wanted	409
VI	More Mobility Wanted	410

1926

I	A Review of 1925	412
II	Adam Smith as Economist: the Gospel of Mutual Service	417
	Index	431

1914

I

THE COSMOPOLITAN INTEREST OF LABOUR

[A pre-war article in *War and Peace* for May, 1914, of some interest in view of post-war discussions about reparations and inter-governmental debts. The estimate of the adjustment making much progress in five years and being nearly complete in ten is too low in this age of restrictions on immigration.]

We have heard a good deal of cosmopolitan finance and the consequent interest of the propertied classes in the preservation of peace: it is time we heard something of cosmopolitan labour and the interest of the working class—that great mass of persons whose property is either *nil* or so small that the income derived from it is of very little account compared with that which they obtain by their labour. The leaders of this class are certainly anti-militarist and denounce war with considerable vigour, but they seem sometimes to be influenced not quite so much by humanity and a clear understanding of the real interest of labour as by a kind of professional dislike of "the capitalist," whom it is convenient to blame for war as well as for most other evils. Moreover, they are in advance of their rank and file, of whom the bulk are just as "jingo" as the rank and file of the propertied class and perhaps even more subject to illusions. Consequently there is in this quarter a great field for the exertions of the friends of peace. It is, no doubt, well to convince financiers and wealthy owners of property that war does not pay; but they can often afford it, and are, unfortunately, often willing to afford it, as a mere luxury, so that it is better still to make the prospect of war unpopular with the mass of the people, who cannot afford expensive luxuries. Towards that end we shall have made considerable progress, if

we can make it clear that, for the working class of each nation, war is a game conducted on the principle of "Heads, we share losses with you; tails, you share losses with us."

It is easy to show that if the working population of the world were perfectly mobile, this would be true without any qualification whatever. A victorious country could impose no burden upon the working class of a defeated country which was not shared by its own working class and that of every other country.

Let us suppose that one country defeats another and levies from it an immense capital sum or a perpetual tribute of corresponding amount. The two things are practically identical, since, if a capital sum is exacted, it will be raised by the issue of a loan on which interest will be paid, and it makes no real difference whether, say, forty millions a year are paid direct to a foreign government or to private stockholders who have satisfied the foreign government's demand for a capital sum of, say, a thousand millions, with which we may suppose the foreign government to have immediately paid off its own debt; so that all that has really happened is that the victorious country's taxpayers will have forcibly transferred to those of the defeated country their own obligation to pay £40,000,000 per annum to stockholders. Let us further suppose that of the thousand millions only eight hundred are required to indemnify the victor for the cost of the war, the other two hundred being pure profit, while the defeated country has spent nine hundred on the war in addition to having to meet the payment to the victor. The victor will now be £8,000,000 per annum better off than before the war, and the defeated party will be worse off by £76,000,000, that being the interest, at 4 per cent., on the nine hundred millions spent, together with the forty millions per annum for the indemnity.

Now imagine the victorious country quite determined that its working class should have the £8,000,000 and the defeated country quite determined that its working class should pay the £76,000,000: the former takes off 2*d.* a week from the employees' contributions to national health insurance and the latter levies an additional 2*s.* a week along with those contributions, the 2*d.* being just sufficient to absorb the £8,000,000, and the 2*s.* to supply the £76,000,000. Labour being by hypothesis perfectly mobile, real wages for equal work must before the war

have been on a level throughout the two countries and all other countries, and on the same hypothesis it is impossible that they can now be increased by 2*d.* a week in the victorious country and reduced by 2*s.* a week in the defeated country without causing at once a compensatory movement. The country which offers the extra wages will attract, and that which offers the lower wages will repel, until a level between all countries is again reached. The new level will, of course, be lower than the old by as much as is necessary to provide the whole of labour's contribution, whatever it may be—of course, property will contribute something—towards the total cost of the war, and thus labour's contribution will be spread over all countries, including the victorious country.

It will doubtless be objected that, in fact, the working population is not mobile. But it is. In the seventy years between 1841 and 1911 the population of the United Kingdom increased about 70 per cent. Take this standard and compare it with what has happened in various other cases. If the population of Herefordshire had increased 70 per cent. in the same time it would in 1911 have been 193,000 instead of 114,000; if the population of Greater London had increased only 70 per cent., it would have been 3,800,000 less than it was; England at the same rate would have had 9,000,000 less people than she had, and Ireland would have had a population of 13,900,000 instead of her actual 4,400,000. Mobility such as this, it may be said, has always been admitted to exist within the confines of a single "country"; it is as between different "countries" that mobility has been denied, and "countries" for this purpose may be defined as the areas between which wars other than civil wars (in which nobody seems to be able to see any good) are prepared for. Let us then take different countries. We shall find that the population of Germany (exclusive of the annexed provinces) grew in the seventy-year period by about 10 millions over and above the United Kingdom 70 per cent. standard; that of France, omitting territory gained and lost, fell short by about 16½ millions; while that of the United States exceeded the standard by nearly 63 millions, a number greater than the combined population of the United Kingdom and France in 1841 and nearly equal to that of Germany in 1911. Why have these immense changes in the distribution of population taken place? Certainly not because each country is a population-tight compartment in which increase

and decrease is regulated by differences of fecundity and instinctive philoprogenitiveness, joined with purely inherited differences of mortality. We may be likely to think so if we look merely at France and Germany at the present moment; here, we may say, we have a country of low natality and nearly stationary population; there, one with high natality and a rapidly increasing population: what more is wanted? But the enormous increase of population in the United States and other parts of North and South America is not due to specially high natality or low mortality. The dominating cause of the different growth of population is the difference in the economic attractiveness of the different countries. In the past, and no very distant past, Germany was a country of great emigration, and would be so again under similar economic circumstances. The French stock in Quebec propagates itself much more rapidly than the same stock in France, and there is little reason to suppose that, if France had resources offering the same chances of favourable employment as Germany and the United Kingdom, more children would not have been born in French families. If not, there would have been a greater influx into France from Italy and other countries and less movement from those countries to America.

Even at the beginning of our seventy-year period, Brassey, the great railway contractor, found the price of labour of equal efficiency nearly on a level throughout the railway-building countries. Competition is wider and keener and movement is easier now than then, and there are few illusions about war more complete than the belief that it can ever now result in the working class of one country being maintained for any considerable time in a worse or better condition than those of equal efficiency in other countries. The necessary adjustment will take time, no doubt, but it will have made much progress in five years and be nearly complete in ten.

The man who lives by his labour is a citizen of the world, taxed not only for the wars, successful and unsuccessful, of his own country, but also for those of all other countries.

II

HOUSING BEFORE THE WAR

[A review-article written just before the outbreak of the War, and printed in the *Economic Journal* for December, 1914, on *The Land: The Report of the Land Enquiry Committee*, Vol. II, Urban.]

The names of the Committee are given on the title page as follows: A. H. Dyke Acland (Chairman), C. Roden Buxton (Hon. Secretary), E. Richard Cross, Ellis Davies, De Forest, E. G. Hemmerde, J. Ian Macpherson, B. Seebohm Rowntree, R. Winfrey, with J. St. G. Heath as Secretary, R. L. Reiss as Head Organizer of the Rural Enquiry, and H. E. Crawfurd as Head Organizer of the Urban Enquiry. Presumably they all agreed, with the exception of Baron de Forest, whose views are expressly said not to "coincide with those of the other members of the Committee." The rural and urban parts of the inquiry were apparently never intended to relate to the same things, as we are told that the Committee was appointed by "the Chancellor of the Exchequer" ("Mr. Lloyd George" would, I think, have been more accurate, the inquiry being unofficial) to obtain "an accurate and impartial account of the social and economic conditions in the rural parts of Great Britain," but of the "nature and working of the existing systems of ownership, tenancy, and taxation and rating of land and buildings in urban districts and the surrounding neighbourhoods, and their effect on industry and the conditions of life." The quaint title, *The Land*, gives the key to this curious arrangement: in the country "the land" is supposed to dominate everything, and therefore the Committee could be directed to inquire into everything, while in the towns it was allowed that there might be some evils which could not be ascribed to the laws of England and Scotland in relation to land.

But even so the "urban" part of the Committee's task is one of stupendous magnitude, and it would not have been surprising that the "urban" volume should have run, as it does, to over 700 pages, even if it had been well arranged and concise, which it certainly is not. It is divided into four parts, "Housing," "Acquisition of Land," "Tenure," and "Rating." It would be natural to expect Tenure to come first in an account of the "nature and working of the existing systems of ownership,

tenancy, etc." ; the arrangement adopted is doubtless due to the fact that the "Tenure" part is the dullest of the four, and to the belief that an atmosphere unfavourable to existing systems could best be created by beginning with a lurid account of the bad house accommodation to which the less well-to-do people of the country have to submit.

The first chapter of this Part I insists at great length on the fairly well-known facts that large numbers of persons are exceedingly ill-housed, and that this, like bad feeding and bad clothing, is bad for them and also, indirectly, for others. The second chapter asks why the legislation which has been passed on the subject has "not actually solved the housing problem" (p. 6, cp. p. 45), a phrase which shows a touching confidence in the efficacy of statute law such as seems to have prevailed in parts of the Middle Ages. After enumerating reasons which are numbered (*a*) to (*h*), the writers arrive suddenly at (*k*), "perhaps the most weighty of all the reasons why the Acts are not fully put into force," namely, "shortage of alternative accommodation." The housing problem, in fact, has not been solved because there are not enough good houses! Theoretical economists doubtless arrived at this conclusion a long time ago, without leaving their proverbial arm-chairs, but it will be gratifying to them to have their opinion confirmed by the more laborious methods of a political committee. Their satisfaction will be increased when the Committee proceed to remark, just like an economic textbook, "the poor go short of house-room just as they go short of other commodities" (p. 59). They might have added that as we are all more or less poor, we all go more or less short of house-room, but the want of house-room gets gradually greater and greater the poorer we are, till at last the poorest of all have to put up with a seat on the Embankment.

I can see no reason why a committee, however anxious to find something wrong with "The Land," should not have frankly accepted this explanation of the "shortage of houses," so far as the demand side of the question is concerned. Every value is dependent on supply as well as demand, and so the fact that people can get plenty of house-room, and good house-room too, if they can pay the price, in no way stands in the way of inquiry why the present price is what it is and how it may be lowered. But the Committee at this point turn aside and spend a great

many pages in a perfectly futile attempt to prove that there is an "unsatisfied demand for houses on the part of working-class households willing and able to pay an economic rent, i.e., a rent representing a sufficient return upon the capital invested to make house-building remunerative, assuming the site to have been acquired or leased at the normal market value for the district" (p. 59).

An unsatisfied demand of persons willing to pay a remunerative price under ordinary conditions is always accompanied by an actual price in excess of a remunerative price, which excess encourages supply. If there is an unsatisfied demand for houses by persons who are able and willing to pay remunerative prices or rents, the actual prices or rents must be in excess of what is remunerative, and the reader consequently expects the Committee to proceed to endeavour to prove either that house-building or house-owning is more remunerative than other investments, or that land for building is sold or leased at more than the market value. But there is no hint of any such attempt. The Committee seem not to understand their own proposition, as they calmly proceed as follows immediately after the passage just quoted:

> "If in any given locality there are working men regularly employed, or having a definite prospect of regular employment, who, with existing transit facilities, cannot obtain suitable houses near enough to their work to enable them to reach it without unreasonable cost or fatigue, at rentals within their income, then there is in that locality a genuine shortage of dwellings. Unless some such definition is agreed upon, discussions on the 'house famine' are apt to lead only to confusion and misunderstanding."

It is truly amazing that eleven persons could make themselves responsible for an attempt to avoid confusion and misunderstanding by mixing up a shortage of houses, in the sense of houses not being forthcoming, *although people were able and willing to pay a remunerative price for them*, and a shortage of houses in the sense of houses not being forthcoming for all the people who would be glad to live in a particular locality "at rentals within their income."

Not an atom of evidence, or even of tittle-tattle, is brought forward to show that house-building or house-owning for the working classes or others is more remunerative than other busi-

nesses, nor that sites can only be obtained at more than "the normal market value for the district." All that is adduced is a large number of tiresome reports from various places to the effect that more houses of quite unspecified size and quality, and therefore of unspecified cost, could easily be let at various rents under 10*s*. a week. There is not even a bare allegation that it would be even ordinarily remunerative to provide these houses. Some of the quotations from reports illustrate quite comically the capacity of the Committee to see that every silver lining has its dark cloud:

"HARTLEPOOL (Population, 20,615; decrease, 9·3 per cent.)—The decrease in the population of the borough is largely due to the fact that the decent class of workmen demand, and rightly, clean, wholesome houses, and at present we are unable to supply their wants."

In the absence of any statement that evictions and demolitions have taken place, anyone less determined to be miserable than the Committee would be inclined to think that a decrease of 9·3 per cent. in the population of a particular small area indicated improvement in housing conditions. In the same space nine persons are less overcrowded than ten.

"The population" is throughout a kind of fetish to the Committee. It is something which is to be accommodated in a particular locality at no matter what cost, the restraining influence of a want of houses being entirely removed by the organized force of the inhabitants of the whole national territory. There is to be a "permanent supply in every locality of enough suitable dwellings to meet the needs of *the population*"; authorities are to "see that adequate and sanitary housing accommodation is provided for the working-class population employed or reasonably likely to be permanently resident within their area" (p. 113). It apparently never occurs to the Committee that "the population" of an area is a thing which depends upon many different circumstances, among which is, and ought to be, the cost of housing it there. If the Committee could succeed in persuading the State or some misguided group of philanthropic millionaires to provide adequate accommodation for the working-class population employed, or reasonably likely to be permanently resident within the area, at "rentals within the income" of working-class people, I have no doubt that in fifty years or less

they could increase the population of almost any small town with a railway station in the middle of England to a million. Certainly no one can doubt that the population of Liverpool, of Birmingham, and still more of London, would be immensely greater than it is if only somebody would provide adequate accommodation for the working classes at rentals within their incomes. The Committee are aware that "private enterprise has hitherto erected about 99 per cent. of the working-class houses in the country, providing annually about 18 million pounds' worth of such houses" (p. 99). They have apparently never given a thought to the question why these houses have been erected in one place rather than another, to say nothing of the question how far the distribution has been a good one. They are content to propose measures which would destroy the existing control without putting anything in its place.

Fortunately, useful practical suggestions are often made by people whose fundamental position is quite unsound—indeed, if it were otherwise the world would scarcely carry on. But the Committee do not seem particularly successful in this. One of the causes of "the present acute shortage," we are told, is the Finance (1909–10) Act, 1910, though "it has been a much less important factor in checking the supply of houses than many of our informants quite conscientiously suppose" (p. 83). Another is the recent increase in the cost of building; and a third, very strangely, is "inability to secure higher rents." "While houses cost more to build, it is not possible to obtain an appreciably higher rent for them." The reader cannot help feeling that if the rents had been much higher, the Committee would have found that an irrefragable proof of acute shortage; but as rents are not much higher, that will do for a cause of shortage. Restrictive by-laws are mentioned, and local authorities blamed for them, though every one with any experience of local government from the inside knows that the restrictive by-laws all came from Whitehall, though Whitehall is now anxious to shuffle off the responsibility. The effect of the boom in trade is curiously misunderstood. The Committee believe that a boom could only increase the demand for house-room in "industrial centres," as if they thought that a greater demand for houses can only come from an increase of population, and not also from an increase of means. To the suggestion that when people are better off

they ask for and are ready to pay for larger and better accommodation, the Committee would doubtless reply that the working classes were not able to pay more because the rates of wages had not risen sufficiently to cover the rise in the prices of other and more necessary commodities. But this argument is based on the vulgar confusion between rates of wages and earnings. The boom did, in fact, by better employment and overtime, give the working classes incomes more than sufficiently increased to meet the increase of prices, and in any case if house rents did not rise as much as other prices, this would appear to indicate that houses were less acutely short than other things. Moreover, the Committee's sharp distinction between a demand for working-class house-room by the working class and a demand for house-room by other classes is obviously quite untenable. There is no sharp line either between the classes or between the houses; the working classes are continually invading whole districts formerly occupied by non-working-class people, and even the reverse process is not unknown, as in Broadway (Worcs.) and Chelsea.

It is curious the Committee should have made no attempt to discover the actual remunerativeness of investment in working-class houses, since the probability is that it is really on the average somewhat above that obtainable on other home investments. Such houses are "undesirable property" to the well-to-do, respectable investor. He does not like exacting small payments from persons poorer than himself, and he fears the obloquy involved in being a "slum-owner." Thus the business of satisfying this want is left to a class of persons with a few hundred pounds each, who cannot own enough property in different localities to eliminate risk, and who therefore collectively get a higher return than would be necessary if the property were held by wealthier people. Some of them can no doubt give individual and intelligent attention to their property, and this tends to economy; but every one knows that large quantities of this small property are constantly falling into the hands of incompetent widows and minors, with disastrous results in dilapidated and derelict houses. The situation would be much improved if there were more people to whom an additional quarter per cent. would be sufficient compensation for the odium of "slum-owning," or if this odium could be lessened by an improvement in public opinion, or escaped by some corporate organization which would

stand between the sensitive investor and his ill-informed critics. Alterations in the law doing away with the antiquated privileges of the landlord, and at the same time making it easier for him to get rid of bad tenants, would also help.

I have left myself no space to deal with the other parts of the Report. They are not so feeble as the Housing Part, but the reader will be tired by the repetition involved in saying everything once, and then saying it again in the form of "summary of conclusions and recommendations." Taking it altogether, it seems likely that the Land Committee will be classed by the historian of the future along with its model, the Tariff Commission. The orthodox Royal Commission seems to have little to fear from its unofficial competitors.

III

THE FIRST WAR SLOGAN: "BUSINESS AS USUAL!"

[A letter to a friend and old student of the School of Economics who had asked what I thought of the cry raised at the beginning of the war, demanding that every one should go on as if nothing unusual was occurring, the idea being that this would prevent business losses and unemployment.

My conjecture in the second paragraph that the cost of the war might amount to one-fifth of the previous aggregate income of the inhabitants of the country was doubtless too low, but not nearly so much too low as it appears if we measure by money without allowing for the great decrease in the purchasing power of money which took place.

The suggestion of the third paragraph that no outside purchaser for capital belonging to the people of this country could be found was falsified to an appreciable extent by the sale of securities to the people of the United States.]

August 20, 1914.

DEAR REID,—

I have been reluctant to add to the general cackle, but as you ask what my advice is on the fashionable question, "economizing" versus "spending as usual," I must say something.

It ought to be obvious that if the inhabitants of this country are to spend perhaps a fifth of their previous income upon the war, they will be obliged, whatever advice they may be given, to spend less upon other things (including of course new investments). Their aggregate income is certainly not enlarged by

the war. On the contrary, it is diminished by the withdrawal of a large number of young men formerly engaged in producing valuable objects and services, and also by the hindrance to foreign commerce, which *would* diminish income very largely even if the people who produced the exports now stopped could be transferred in an hour to industries which would produce the things formerly imported and now stopped, and which actually diminishes income much more, inasmuch as such an easy transference is not possible.

Now if people have less income, how can they avoid spending less for current needs and new investments taken together? One wiseacre has suggested that they should spend their capital. How can that be done unless there is somebody outside to give them money for their stocks and shares and other property, and where at the present moment can such a purchaser be found? In the other countries at war? In the new countries which look for capital to the old? In Turkey and China? Under the circumstances the smaller income must mean smaller—very much smaller—expenditure for all non-warlike purposes.

(1) Expenditure on new investments is likely to cease almost entirely. Nearly all savings, instead of taking their usual form of industrial capital at home and abroad, will be lent to the Government, and be forthwith spent in the war. The stoppage of home investment will mean a complete slump in the building trade and other trades which, like it, are chiefly employed in producing additions to the material equipment of society. Of course this slump will drive many workers out of those occupations into others more urgently necessary in which there is a shortage owing to the departure of soldiers or to the greater quantity of produce required, or to the greater difficulty of producing the old quantity. (The pinch has not come yet, and so here I have seen the absurd spectacle of the Local Labour Exchange appealing for volunteers to get the harvest in, while there were hundreds of men building houses, which may not be wanted for years, within sight of the standing sheaves which were waiting to be carried). The stoppage of the investment of British savings in the colonies and foreign countries will have similar effects in those parts of the world, which we need not follow out; so far as we are concerned the effect will be manifested in a tendency for the excess of imports over exports to increase largely,

so that alarm lest the difficulty of exporting should lead to a shortage of necessary imports is quite unjustified. We shall cease to acquire new property abroad, but we shall not starve.

(2) Though the emergency can thus be met to a large extent by the diversion of savings from ordinary productive investment to investment in Government loans, it certainly cannot be altogether met in that way. The ordinary current expenditure of individuals and institutions of all kinds must also be cut down. Common sense and a proper self-interest will lead them to cut it down where it will hurt them least. All sorts of luxurious, or perhaps it would be better to say less-necessary, expenditure will quite properly be reduced first, and willy-nilly the number of persons engaged in trades which produce the less necessary things must be reduced—labour force must be driven out of them into channels where it is more urgently required.

I do not think people will be much affected by advice given them. It is difficult to imagine what would happen if every one tried to adopt the advice to go on spending regardless of prospective reduction of income. I suppose there would be a terrific financial crisis if credit allowed the experiment to go very far. On the other hand, if every one took the advice to "economize" as much as he possibly could, there would be a quite unnecessary absolute shutting down of a great many trades which would be required again as soon as the fit was over. "Act prudently and not in a panic-stricken manner," is the only advice I should venture to give. Exactly what people should spend must depend on how long the war will last, and how much a hitherto very foolish Europe makes up its mind to spend on armies and navies after the war is over. I dare say the average estimate of these factors is as good as yours or mine.

The only thing to add is that though in a usual way it is not possible for an individual to follow in detail the actual effect of his own particular expenditure, it is sometimes possible, and in those cases the patriotic or philanthropic person who has sufficient means to enable him to choose between various kinds of "economy" should choose those which will be obviously economical to the nation as well as to himself rather than those which will only save his own pocket. For example, if it is a choice between dismissing a gardener who will enlist or take up the work of some other man who has enlisted, and dismissing a

woman servant who has no chance of employment during the war and perhaps after it, by all means let the gardener go. In the purchase of commodities it would require a wider knowledge than the ordinary individual is likely to possess to enable him to make corresponding decisions. It would probably be well, however, to favour as far as possible the trades in which women are the principal producers. The demand of war upon men must certainly mean a deterioration in the general value of the services of the other sex during the continuance of that demand.

IV

LABOUR IS NOT A CURSE NOR EVEN A COST

[Part of a review of J. A. Hobson's *Work and Wealth: A Human Valuation*, 1914, in the *Economic Review* (the organ of the Oxford Branch of the Christian Social Union) for October, 1914.]

THE earlier part of the book consists largely of a protest against neglect of what may be called the negative side of production. It is evidently wrong to measure economic welfare simply by output without regard to what Mr. Hobson calls the "human cost"—the pain and disagreeableness of producing the output. So far as regular economic teaching is concerned, I should imagine his protest is now belated, but it is doubtless true that there is a small school of "economy of high wages" theorists—particularly strong, I fear, among the Christian Social Union—who seem to think the only remedy for low wages is to make people work harder. One thing I find lacking in Mr. Hobson's exposition is a clear recognition of the fact that labour in itself is no curse but a blessing. Over-fatigue and disagreeable and painful incidents are "human cost," but mere labour is healthy and happiness-giving. Mr. Hobson would admit this, I gather, of exertion undertaken from artistic and perhaps from "sporting" motives, but deny it of ordinary routine labour. This I believe to be wrong. Let any reader ask himself, honestly, whether he is not really the better for a certain amount of work which he does not want to do, but is obliged to do. If he doubts it in his own case, let him ask others about himself—and ask wives about their husbands. It is not the drudge but the artist that is "gey ill to live wi'," and makes himself and others unhappy.

1915

I

"HURRY UP PUBLIC EXPENDITURE"?

[The fact that all work not immediately necessary would have to be stopped was still unrecognized.]

February 24, 1915.

Dear Sir Thomas Whittaker,—

I see that you have very rightly been urging that the Local Government Board and the Board of Education should impress on local authorities that this is not a time to incur expenditure. I don't know about the Board of Education, but so far as the L.G.B. is concerned, it seems to me that you might have put the admonition a good deal stronger, in the form of "the L.G.B. should drop its present policy of urging local authorities to incur at once expenditure which can and ought to be deferred till men begin to come home after the war." At any rate this is suggested by the two extracts which I enclose, cut from newspapers received this very morning. It is, I admit, possible in both instances that the L.G.B. thinks the councils concerned will not actually get to work till the conclusion of the war, and that it is well that preliminary arrangements should be made now: but it is far more probable, I should say, from what I know of government departments, that it is carrying out the "business as usual" policy which was widely advocated six months ago and is now generally seen to be absurd. When another six months have passed and it is time to start again, the department will have arrived at the present stage of outside opinion.

The Post Office is another offender, having been engaged in replacing overhead telephone lines by underground cables, even in purely residential districts where the telephone is a mere

luxury. I have already written to Sir George Gibb about this, as he is on the munitions of war committee, and he has sent my letter to the P. M. G.

What a mercy it is that the ordinary person is *forced*, by high cost and diminished means, to refrain from unnecessary employment of men and materials! If he followed the precepts of the Press and the example of government, we should indeed be in a poor way. I am sure the attempt to prevent anyone suffering anything (except of course, violent death, wounds and bereavement, which seem to be taken as a matter of course) from the war must fail, and the only question is in what kind of crisis the inflation of spending power caused by it will end. I have written an article in the coming *Contemporary* on the immense service rendered by the existing rise of prices.

I am glad to think that your book had such a good reception. Apparently the war has not stopped people reading economic works. It is said that ordinary fiction has quite collapsed, presumably knocked out by the war reports!

II

WHY SOME PRICES SHOULD RISE

[An article in the *Contemporary Review* for March, 1915, entitled "The Good Side of Rising Prices." I have altered the title because "rising prices," now at any rate, suggests a general rise of prices, which, as the second paragraph explains, is not at all what was intended.]

We often see the legend "Popular prices," but prices are never popular either with those who pay them or those who receive them. Even when they have been stationary for a long time, so that both sides have become accustomed to them, the payers think them a little too high and the receivers think them a little too low. When they move from their accustomed level a howl of rage arises. Sellers who have to take lower prices for their productions are sure that they will be ruined, and almost invariably persuade themselves that their ruin will drag down the particular nation to which they regard themselves as belonging. Buyers who have to pay higher prices suddenly become either "the poor" forced to reduce their consumption of neces-

sary articles, or else employers of a particularly needy and deserving class which will be thrown out of work by the rise. All the injured persons are at once represented as being iniquitously robbed by an unscrupulous gang of speculators, middlemen, blood-sucking capitalists, or rack-renting landlords against whom all the resources of the State ought to be brought forthwith. The ideal somewhat vaguely held seems to be an immediate return to the prices of a few months or a year ago.

With those general rises and falls in the value of goods measured in gold which are merely the reverse side of falls and rises in the value of gold measured in goods, I do not intend to deal here. They are almost obviously bad, and there is no doubt that the remedy will ultimately have to be found in a cosmopolitan regulation of the output of gold or whatever may be adopted as the standard of value. This remedy certainly cannot be applied under the present international conditions, and it is therefore unnecessary to talk about it at the moment. Moreover, whatever general rise of prices attributable to currency conditions there may be at present, the convulsion of particular prices is far more obvious and important.

When the war began, people thought a good deal of the things which would become unsaleable at their previous prices, and of the resulting unemployment of those who had been employed in producing them. We shall hear more of this when peace arrives. Just now attention is concentrated on the things which have risen in price, and the rise, as usual, is regarded as bad.

An old epigram says that high prices are their own cure, and I suppose hardly anyone will deny that there is some truth in the suggestion. If the price of a thing which can be produced goes up, and is expected to remain up, we usually suppose more of it will be produced than would have been produced if the price had remained where it was. At the present moment, for example, we are expecting a great deal more wheat from the next harvest than would have been forthcoming if wheat had remained, and had been expected to remain, at its pre-war price. It is conceivable that the various governments of the world might have all established maximum prices for bread at the old level, and have resolved to maintain these maxima, and that every one might have had complete confidence in their ability to do so. In that case no farmer would have expected to get a higher price than

before, nor, consequently, would any farmer have had any inducement to increase his crop: on the contrary, indeed, he would have been induced to diminish it, since the materials for substitutes for wheaten bread not touched by the settlement of maximum prices would have become relatively more profitable crops. So, too, if the price of coal rises violently in London, so that the difference between the price there and the pit-mouth price is such that anyone who chooses to ship it from the north-east coast can get three or four times the usual remuneration, we are inclined to think that before very long more coal will be carried by ship to London than would be carried if by some means freights were maintained at the old level. In one respect, indeed, a good many people behave in a way which might at the first blush suggest that they do not follow this reasoning. When the price of a thing goes up, they abuse, not the buyers nor the persons who might produce it and do not do so, but the persons who are producing and selling it, and thereby keeping down its price. If we follow the reasoning which I have suggested, it certainly would appear to be a most extraordinary example of the proverbial ingratitude of man when he abuses the farmer who does grow wheat because other farmers do not, or when he abuses the few shipowners who carry coal to London because there are not more of them. But have we not all heard the preacher abuse his congregation because it is so small? We must not imagine that anyone really believes that offering a thing or service for sale tends to raise its price. Possibly recognition of the fact that sellers tend to lower prices is a little obscured by the old notion that labour creates value. If labour created value, it would be right to suppose that the producers of wheat and the carriers of coal made the prices of those articles. But labour does not create value; if it did, the labourer would be the enemy of the human race. By producing things or performing services he in fact, diminishes the value of such things and services. More probably the popular dislike of those who sell things when buyers particularly want them is a mere reminiscence of mediaeval ethics. And perhaps a little of it is vulgar envy.

This, it may be said, is all very well when encouragement of production is actually possible, but what can you say for high prices in situations where it is not? In the first place, it is necessary to observe that these situations are not quite so frequent

as is very widely supposed. It is often supposed, for one thing, that where there is a monopoly, high prices fail to encourage production. But a moment's thought shows that this is an error. The monopolist who ordinarily sells a certain number of an article at a shilling, and suddenly finds that owing to some change the same number can be sold for two shillings, is not in the least likely to refrain from effort to increase his output. If the sea-carriage, or even the sea and land carriage, of coal to London were in the hands of an absolute monopoly, it is not in the least likely that a rise of freights from 3*s*. to 14*s*. would not make that monopoly desirous of increasing the ships and men employed in the trade. In the last few years a very striking example of the desire of a monopolist to increase the quantity of what he sells has been furnished to Londoners by the body which controls most of their means of locomotion. It is often said, too, that while a slow moderate rise of price must be admitted to have good effects in increasing production, a sharp rise for, say, a month or two "is not long enough to have any effect," or, if the speaker is fond of the technical terms of recent economics, that such a rise of price "only gives the producers a producer's surplus which will not call forth additional production." It ought to be obvious, however, that people do not carry on business merely for what they can get in normal times and bad times averaged: occasional stretches of good times are always taken into account, so that if an emergency is so sudden and short-lived that the high price it causes cannot be regarded as curing itself, that high price must usually be averaged in with the rest. After all, the average freight on coal for a year, or even ten years together, is more important to both the shipowners and the consumers than the freight for a couple of months.

There are, however, certain very exceptional circumstances in which it is really true that high prices cannot encourage production, for the very good reason that no further production is possible during the time which they will last, and after that the events which caused them are not expected to recur. The stock example of such exceptional cricumstances is the siege of a town which is not in the habit of being besieged. If the town were in the habit of being besieged, the high prices obtainable for provisions during the sieges would no doubt soon lead to a good stock being maintained in it, so that the siege prices would be

kept lower, and it could still be said that high prices were their own cure. But sieges are happily of such rare occurrence in modern times that nobody foresees them, and consequently we have to take into account no such effect; the prices in the next siege will not, any more than those in the intervening period, be in the least affected by the prices in the siege of the moment. Production has not to be thought of: all that is to be done is to make the existing stock of provisions go as far as possible. There is no question of high price curing itself: the only question is whether it is one of those things which cannot be cured and must be endured.

The first impulse of the natural man is to say emphatically that the answer is in the negative. "Why should we enrich these people who by a pure chance happen to have considerable stocks of provisions in the town? Let them sell at the prices to which we are accustomed and be thankful that we do not commandeer the whole without paying anything." The Government of the town agrees, and issues an ordinance fixing maximum prices very slightly above the ordinary rates. People then, very naturally, eat and waste as much as usual. The Government makes inquiry into the amount of the stocks and finds that, with economy, they will last until the period at which it expects the siege to be raised. It issues, on bills and in the official newspapers, exhortations to economy, and the restaurants cease to put bread on the plates until it is asked for. Nobody is alarmed, and the normal life of the city is carried on as usual. The Government allows a slight rise in maximum prices; the socialist papers protest violently on behalf of the poor. A fresh census of stocks is made, and it is discovered that, in spite of all exhortations to economy, nearly as much as usual has been eaten. A continuance of the policy adopted will obviously end in all the provisions being finished before the date at which the siege may be expected to be raised, and some drastic scheme has to be adopted for cutting down the consumption to a much lower level. People wish that it had been cut down earlier, because it is less disagreeable to live on three-quarters of your usual daily quantity for six months than to have the usual amount for the first three months and only half the usual quantity for the other three months. The socialist papers then abuse the Government for having "acted too late," regardless of the fact that it acted

at the very beginning by imposing the maximum prices; and that action, if it was at all effective in keeping prices down below what they would otherwise have been, at any rate assisted in causing the trouble. If the prices had been higher, consumption in the early period would have been more checked, and the total stock consequently better spread over the whole time.

Mere repression of prices can only be defended when the Government is more optimistic than the market, and has, in fact, good grounds for its optimism. At the outbreak of the present war a number of silly persons rushed to the shops and bought up large stocks of flour, eggs and such-like things, to say nothing of absurdities like night-lights. If every provision shop had chosen to sell out to the highest bidder at the earliest possible moment, considerable inconvenience, and even suffering and loss of life would have followed in many localities, owing to the whole stock getting into the hands of these pernicious persons and nothing being available for days or weeks for their betters. Fortunately the shopkeepers of this country are an admirable class, gifted with a self- restraint that enables them to pass by immediate gain when it will be followed by loss of custom in the long run. They answered fools according to their folly by dumping all their stale and damaged goods upon the panic-stricken hoarders, but refused to deplete the rest of their stocks, so that they were able to go on supplying their ordinary customers with their ordinary amounts. I do not know that the maximum prices then fixed by the Government helped them in this course, but if they did, they were useful, and, whatever may have been the case in this particular instance, it is possible to conceive somewhat similar circumstances in which a Government which was powerful and ubiquitous enough to enforce maximum prices might be able to suppress a panic-stricken rush. In general, however, when a Government is more optimistic than the market, especially where the market is a wholesale market not immediately affected by the vagaries of unbusinesslike people, the optimism of the Government is likely to be ill-founded, so that the field for the application of maximum prices is very small.

In extreme cases the system of prices breaks down, and must be replaced by the system of rations served out by authority, not because it does not distribute the available stock over time better than any other machinery likely to be devised in the circum-

stances, but because it fails to distribute the stock in the best possible manner between individuals. In ordinary circumstances we tolerate an entire divergence of distribution from wants because we do not know how to do away with it without wrecking our whole organization for production. But considered in its immediate results, distribution according to need, which, where healthy adults are concerned, means approximately equal distribution, is obviously the most economical. In the besieged city, where ultimate effects on production are negligible, the economy of distribution according to need invariably asserts itself. It is felt, not only as in ordinary times, that a man with no means must not be allowed to starve; but also, further, that no man must be allowed to have more of the necessaries of life than others merely because he has command of much money. Hence the universality of the ration system in sieges of any considerable severity. But even here circumspection is necessary, as we may see at once if we think out the different consequences of equal rations of bread and equal rations of coal. In ordinary times immensely more coal is used per head in wealthy than in working-class households, but it is certainly not so with bread. Probably the well-to-do households actually use less bread and flour per head than the working class. Consequently, except where the scarcity was very acute indeed, equal rations of coal would take away from the rich and give to the poor, while equal rations of bread would not, but might even work a little in the opposite direction. For example, at the present moment, if coal were served out in equal rations in London, and all transfers prevented, families with £2 a week and under would have more than they knew what to do with, while households with a thousand a year would find it difficult to keep a quarter of their usual fires going. If bread were treated in the same way, the wealthy household would suffer no manner of inconvenience except, perhaps, that of having to waste a little more than usual, and the working-class household would get the same or very slightly less than before. If sales were permitted, the poor would sell some of their coal tickets to the rich, and the rich would possibly sell some of their bread tickets to the poor; the equal rations of bread would be much the same as an equal money allowance, while the equal rations of coal would be a clumsy equivalent of a money allowance graduated in favour of

the poor—the clumsiness alleviated to a considerable extent by the permission of purchases and sales.

On every occurrence of an unusual rise of price there are found persons who are willing to admit everything that may be said in defence of prices "in the abstract," or "when the prices are natural and not artificial," but who are perfectly convinced that the rise with which they have to contend for the moment is unnatural, artificial, and wholly unjustifiable, being merely the wicked work of people who want to enrich themselves, and who are given the power to do so not by the economic conditions, such as those resulting from the carrying on of a war in which more than half of the area and population of the world is concerned, but apparently by some absolutely direct and inexplicable interference of the Devil. This has been so since the dawn of history, and no doubt before, but no amount of historical retrospect seems to be of much use. The same absurdity crops up generation after generation.

The proposition most relied on is that "the rise is obviously unjustifiable" (either for encouraging production or for economizing consumption) "because it is out of all proportion to the deficiency in quantity." Those who put this forward have at the bottom of their minds the curious assumption that prices "naturally" vary exactly, though inversely, with the quantity offered, so that, for instance, if the harvest is three-quarters of its average magnitude, the price of the bushel should be four-thirds of the average price, with the result that the whole harvest should always sell for the same aggregate amount of money; or if the quantity of coal coming to London falls off 10 per cent., the rise of price should similarly be one-ninth, so that the aggregate amount paid may remain the same as before. But, of course, this is palpably absurd. In the well-known estimate attributed to Gregory King which Davenant printed in 1699 it was calculated that a deficiency in the harvest of 10 per cent. would raise the price of the bushel 30 per cent., a deficiency of 20 per cent. would raise it 80 per cent., and a deficiency of 50 per cent. would raise it no less than 450 per cent. Davenant did not suppose the difference was due to the iniquity of the farmers, nor to some strange obliquity of vision which made them think it would be profitable to keep back much of the corn in order to sell it at the probably much lower prices of the next year;

he takes it for granted that his readers will think it quite natural that consumers' reluctance to be deprived of their usual modicum of a "necessary" article should send the price up much more than in proportion to the deficiency. It is impossible to argue with those who hold that variations of price should always be in exactly inverse proportion to quantity available, because they never bring forward any reasons for their belief, and, perhaps, scarcely realize that they have such a belief. Let them search for anything justifying it in religion, morals, or economics, and when they think they have found something it will be possible to deal with them. Let us know both why sellers should not sell for the prices they find it profitable to charge, and also what will be the results of their adopting the principle recommended to them. And let it always be remembered that if rises in prices ought to be in proportion to deficiency, it surely follows that when quantity is above the normal, prices should only fall in proportion. A queer world!

Another proposition almost as often relied on is, "There is no real deficiency at all: there is just as much stuff as usual available, but some persons are storing some of it up in order that they may reap a profit." Now sometimes it is true enough that the usual quantity is available for the moment, but that some persons are storing more than usual of it up in order to sell at a future period when the price will be higher still. But what harm is there in that? It is merely part of the machinery by which consumption is kept more equable than production. If, as anyone can see, there will be a great deficiency in certain crops or other produce next year, is it not desirable that some of this year's crops or produce should be held over? It is surely better to have moderately high prices for two years than ordinary prices one year and famine prices the next. Another possibility is that some person or group may find it profitable to get control of the whole crop or stock of produce, and dole out such small quantities to the market that they can afford to face selling what is left when the new supplies come in at a much lower price. To theorists this is a pleasing case to describe, but those who have attempted to carry out the idea have generally burnt more than their finger-tips. In any case an attempt to carry it out must necessarily become notorious and easy to prove.

Its existence is certainly not proved merely by high price

coupled with an absence of both expected and immediate deficiency of quantity. Besides diminution of supply there is such a thing as increase of demand. Some change may cause people to demand more of some commodity even when they are not in a position to increase their total expenditure. The madness of last year, for example, has increased the demand of the world for particular kinds of food, both because feeding large armies in all kinds of difficult situations, with an enemy always trying to prevent it being done at all, is amazingly more wasteful than feeding the same men under the direction of their mothers or wives at home, and because the nations concerned desire that, if possible, they shall be even better fed than at home. Now, if the numerous soldiers eat and waste much more than usual, it is surely obvious that even if the output of food remained the same as before the war, the civilian and neutral population of the world, taken as a whole, must have that much less, and as people particularly dislike giving up their accustomed food they try to avoid the necessity by offering more money, and consequently raise the price, with the highly beneficial results of checking waste, spreading the consumption economically over the period of stringency, and encouraging the future production.

The encouragement of the production of the things which have risen in price, of course, does not appear only in the rise of the profits of those engaged in the trades concerned : it appears also in the rise of the wages of the wage-earners in those trades, and those wage-earners find the unpleasantness of the rise of prices counterbalanced, or at any rate mitigated, by increase of income. But if any member of the working-classes, or, as is perhaps more probable, any bourgeois protagonist of the working-classes, imagines that the working-classes of the world at large, or even the working-classes of any considerable country, belligerent or neutral, are not going to suffer a loss of real wages now and for many years in consequence of the present perversion of a large part of the world's energy from its usual channels to the arts of destruction (which include the production and transport of weapons of war), that man is living in a fool's paradise. The enormous loss could not possibly be thrown entirely on the rich ; and if it could, it would not be. The folly of 1914 has got to be paid for, and the largest class will not, and cannot, escape paying a considerable part of the cost. Nor, as I showed in the

May, 1914, number of *War and Peace* (above, pp. 1–4), will workers get off paying merely because they happen to live in, or choose to migrate to, the victorious countries.

It is no use crying over spilt milk. But, looking to the future, I would suggest to working-class champions that the most pressing need for the ultimate attainment of the good things which they and all other well-disposed persons desire is the establishment of international order. Let them lay to heart the remark which Prof. Graham Wallas in his *Great Society* quotes from my address, delivered in 1909 to the young trade-unionists of Ruskin College, and printed in the *Economic Outlook* in 1912: "A world composed of territorial socialist societies, in which the whole surplus income over bare necessaries was spent in war and preparations for war, would obviously be a more miserable place than the world as we know it." Let them not nourish delusive hopes of improvement in foreign policies when they succeed in putting them under democratic control, but let them go boldly for the abolition of all foreign policies and military forces by the establishment of a Union of States strong enough in the first instance to be neither afraid nor jealous of its neighbours, but always ready to admit new adherents until all are inside it.

III

STRATEGIC JEALOUSIES MASKED AS COMMERCIAL

1.

[A letter to Mr. G. Lowes Dickinson. The fourth paragraph of the letter will be more intelligible to those who remember how, at that time, animosity against Russia had been replaced by warm friendship.]

March 20, 1915.

DEAR DICKINSON,—

Many thanks for your pamphlet, *After the War*, with almost every word of which I agree.

I still refuse to be despondent. The "crushing," and "dictating terms" talk which you reprobate on p. 9 doesn't alarm me much when I think how Milner and Chamberlain insisted that the Boers were to surrender unconditionally, and how all England was illuminated when the war was ended on quite other terms.

The Germans could negotiate a reasonable peace to-morrow if they wanted to.

P. 16, doesn't " States hitherto have measured their worth in terms of population, territory and power " require some qualification ? I shouldn't say that your proposition was true of Norway, Sweden, Denmark, modern Holland, or Switzerland.

I cannot believe that international animosities and jealousies are nearly so deep-seated as is commonly supposed. They seem to me amazingly superficial, and the product of very artificial and temporary arrangements. ——— absolutely refuses to believe that on the night of the Dogger Bank incident, when he thought that war was breaking out between this country and Russia, he came into —— —— and said, " Well, it had to come, and the sooner the better. They are taking away all our trade in the East. . . ." He thinks my recollection is faulty, and that he was really talking about the Germans. Aren't most people like him ?

Non-economists are apt to be deceived by the pretence of economic national interests commonly put forward by professional and amateur diplomatists. Doubtless there are many people who believe that trade follows the flag and will bring their nation (including themselves in some cases but very often not) great profits. But does anyone seriously believe that the professional diplomatists who get their countries into messes like the present really care two pence for such commercial interests ?

Commercial interests seem to me to appear in international quarrels simply as a cover for strategic interests. Where there are not supposed to be divergent strategic interests, no amount of divergent, or supposedly divergent, commercial interests produces either war or preparation for war. Divergency of strategic interest will always be found when war is conceived as a possibility, and will not be thought of when it is not. In the absence of permanent union or at any rate alliance between any two states, war between them will always be more or less of a possibility, and their military servants will consider it a duty to think about it and devise the best means for coping with it. They can scarcely do this absolutely in secret—even their spies will sometimes be caught, as ours were by Germany a few years ago—and consequently they will be helped or more probably hindered by meddlesome busybodies and newspapers.

Then the publics of each of the two countries begin to think that the other is not only preparing, which is a fact, but also intending war. There never was anything which excelled bellicose dispositions in the capacity for making a living by taking in each other's washing.

The belief that war takes place chiefly because it is possible, that the bare possibility makes countries provide for it, and that the provision eventually brings it about, makes me entirely distrust all schemes which admit the possibility. So long as you have separate national military forces you will necessarily have preparations for war and war itself. Where you have not such forces, at the worst you can have civil war, which, owing to the insufficiency of its material equipment, is becoming a less and less serious matter in comparison with international war. The only way to stop international wars is to suppress all separate national military forces and consequently put an end to all strategic jealousies and fears. Mere limitation of forces is impracticable, and probably on the whole would be mischievous if it were practicable, as it would be likely to give rise to more suspicion and nervousness. A people will be quieter and more peaceable if they think they have done all they can to make themselves secure, than if they are bound by some compact not to do quite so much on consideration of some other party doing the same.

But, you say, is it not absurd to suppose that states will entirely suppress their military forces?

Before we come to that question let me ask whether it is not absurd to suppose that after the war we shall proceed exactly as before it.

2.

[The part of a letter to Professor Allyn Young which was sent by him to the New York *Evening Post* and was printed in that paper on May 14, 1915.]

I am in hopes that we are nearing the end of international anarchy, as international animosities seem to me to be rapidly becoming more and more artificial: they are for the most part worked up by persons who are persuaded that something or other is necessary for the strategic safety of their country, and if we could once put strategy out of the question there would,

for example, be no more trouble about the relationship between Germany and the two Low Countries than there is about the relationship between New York State and Connecticut and Massachusetts. "National trade jealousies" do not really exist, apart from military and naval jealousies and fears. Now that we have got half the area and population of the world in alliance, the thing to do is to get the present enemy and then the neutrals to join and turn it into a concert, not of Europe only. If we cannot succeed in doing this, all our means above the merest necessaries will be swallowed up in preparations for the next war, and there will be no hope of any material progress, as every new invention will be simply exploited for military purposes. Isn't it amazing to reflect that over half the land of the world at present no one is allowed either to aviate or to wireless except for military and naval purposes?

IV

AGAINST COAL CONTROL

1.

[Part of a review-article in the *Economic Journal* for June, 1915, on the report of a committee appointed by the Board of Trade in February, 1915, "to inquire into the causes of the present rise in the retail price of coal sold for domestic use, especially to the poorer classes of consumers in London and other centres." [Cd. 7866]. Best Derbyshire, this committee found, had risen in London from 26*s.* in June to 35*s.* in February; inferior coal from 20*s.* to 34*s.*; trolley coal from 26*s.* 8*d.* to 38*s.* 4*d.* The review complains that the Committee expressed "no opinion about the quantity of coal sold in London during the months considered, nor about its average price." It might, the review suggests, be roughly estimated from the figures given that "Londoners paid about 11 per cent. more in the aggregate for 15 per cent. less coal, and the winter was a mild one."]

WHATEVER the exact distribution of the suffering and inconvenience between loss of coal and loss of other things retrenched in consequence of extra payments for coal, it is tolerably clear that the London coal shortage of 1914–15 is by no means to be reckoned, as some thought it at the time, the greatest calamity of the war. The fact that it was borne with less patience than the similar effects of the great coal strike seems to have been due

to the old, old cause of excitement in the presence of scarcity—the belief that the rise of price was due, not to the obvious scarcity, but to the wicked conspiracy of sellers, who, by holding back a really plentiful commodity, manage to draw enormous profits. The Committee found nothing to indicate that the evil passions of the merchants were so particularly excited by the war that they chose this occasion for the extreme exercise of a power which they had always possessed but were apparently reluctant to use in time of peace.

. . . .

It is really amazing that the Committee should finish up by recommending that, "if prices do not shortly return to a reasonable level," the Government should "consider a scheme for assuming control of the output of the collieries of the United Kingdom, with a view to regulating prices and distribution in accordance with national requirements during the continuance of the war." The Governments of Europe, or some of them, by their extreme incompetence in carrying out their most elementary functions, have muddled the world into a prodigious conflict which no one now believes he ever wanted. The necessities of this conflict cause our own Government to take various steps which create an acute shortage of shipping and an intense congestion of railway traffic, and this interference with the normal conditions of transport results in a moderate rise of the price of coal in a populous corner of the country in which the consumption of the wealthy is doubtless a larger proportion of the whole than anywhere else. In order to remedy this the Government is recommended not to be content with its large powers in regard to shipping, and its complete control of the railways, but to assume control of the whole output and distribution of coal!

In making this plunge, the Committee seem to have been inspired by that very dangerous thing, a smattering of economic theory. In section 9 they speak as follows:—

"The effect of a temporary failure in the supply of any commodity is normally that the price rises, and rises without relation to the cost of production and distribution. In theory at least such an increase, though apparently arbitrary, may be expected to perform three functions: it acts as a danger signal, warning consumers to be careful of their stores; it ensures the distribution of the available supplies to those who are willing to pay most, i.e., presumably to those who have the greatest need; and it automatically attracts

further supplies, thus providing its own remedy. This system may work satisfactorily in normal times, but the plain fact is that it has broken down in the extraordinary circumstances of the present winter so far as household coal is concerned. It has no doubt enforced economy among consumers, but it has not ensured distribution where supply was most needed, because the poor could not afford to pay the prices demanded; and it has not attracted additional supplies with enough speed to prevent much inconvenience and suffering, because either normal supplies were not available or they could not be brought up."

The Committee evidently imagined that they were confronted with "extraordinary circumstances" in which the ordinary mechanism did not work as it ought "in theory" to work, and therefore they were encouraged to propose the supersession of the ordinary mechanism. But their belief involves a very imperfect appreciation of the theory of the subject as commonly taught. No economist ever taught that a rise in the price of a commodity attracted further supplies of it when the conditions are such as to preclude the possibility of further supplies, and the occurrence of such conditions has always been present in the minds of economists from Aristotle downwards. Thales of Miletus would never have been rich if olive-presses could have been supplied quickly enough. The price of food in besieged towns, the price of grain between one harvest and the next, have constantly appeared, not as examples of the "break-down" of either "theory" or "system," but as examples which illustrate the working of the "system." The theory has never been that rise of price always reduces consumption *and* increases supply. So far as it does the one, it clearly need not do the other. If the supply is capable of being increased easily and quickly there is less need of reduction in the rate of consumption; if it cannot be increased at all during a certain period (e.g., for the eleven months between harvest and harvest in the pre-southern-hemisphere days), the rise of price is useful because it "economizes" the amount available by inducing people to cut down their consumption in such a way as to make it last over the whole period instead of being finished before the period ends.

Thus two of the three merits claimed by the Committee for rise of price under ordinary circumstances are not cumulative, as they imagine, but alternative, and the absence of one of them is no proof of "break-down." As for the third merit

alleged by these modern improvers on Bastiat, that it "ensures the distribution of the available supplies to those who are willing to pay most, i.e., presumably to those who have the greatest need," they are even more at sea. No one ever before claimed that, as a universal or even a general rule, the higher the price of a commodity, the more it is distributed in proportion to needs. If oranges were a shilling each, they would only be distributed to the rich, like pine-apples now, "because the poor could not afford to pay the prices demanded," to use the Committee's own words. Who, before the Committee, ever supposed that this would be distribution "to those who have the greatest need"? Does Marshall never take any notice of the inequality of wealth, and the consequent absence of correspondence between greatness of need and greatness of purchasing power? Do all teachers of elementary economics ignore it? The Committee might as well report that the rise of water in the short arm of a siphon indicates "the plain fact" that the law of gravity has "broken down in the extraordinary circumstances of the present winter." The effect of the rise of price on the distribution of the amount available is well uuderstood to be different in the case of different commodities, with different elasticities of demand on the part of different classes, and often varies with the magnitude of the change of price. A big rise in the price of bread probably leaves the proportions consumed by rich and poor pretty much as it was; a big rise in the price of oranges would give them all to the rich. Coal is a commodity of which a large part is a "necessary" to all classes, and another large part a "luxury" of the rich, upon which they spend a quite appreciable portion of their means. It seems at any rate probable that a big rise in the price of London coal in consequence of a failure of supply cuts down the luxurious consumption of the rich by a larger percentage than it cuts down the consumption of the poor: the rich take much less coal, the poor take only a little less; the rich spend much the same money as before, or not much more; the poor spend an amount nearly as much increased as the price. The poor are less hit by any given deficiency in the supply of a commodity like this than they are by the same deficiency of a commodity like bread, in which there is little luxurious consumption by the rich (such as there is being waste by servants), and consequently little help from the reduction of that con-

sumption. The poor suffer, no doubt, but when did it begin to be an exception from ordinary rules for the poor to suffer because something they consume has risen in price?

I have insisted on the bad economic theory of the Committee, not because anything else is to be expected from committees of middle-aged men in view of the recent state of education in elementary economics, but because the over-optimism displayed by them concerning the ordinary working of existing economic institutions is exceedingly common, and is constantly leading so-called "practical people" into the belief that whenever any suffering or even inconvenience is noticed by the newspapers, they must be in the presence of exceptional circumstances in which the ordinary system has "broken down," or "theory does not hold good," and which "justify" exceptional measures not in reality in the least likely to work half as well as the arrangements superseded. If in addition to the war, we are to have the Government assuming control of the output and distribution of every important commodity of which the poor cannot buy as much as they want, our condition will be indeed perilous.

2.

[A letter to the President of the Board of Trade. The "rashly promised scheme" condemned in it was carried out in the Act, 5 and 6 Geo. V, prescribing that the price of coal at the pithead should not exceed the 1914 price by more than 4*s.*, and the Board of Trade endeavoured to keep down retail prices by promoting voluntary arrangements among coal merchants; but in the winter of 1916–17 all this had to give way to complete government control of the mines. Daylight Saving was first adopted in May, 1916.]

July 11, 1915.

SIR,—

I enclose a criticism of the Retail Price of Coal Committee's Report, but I wish to draw your attention more particularly to another article in the *Journal* from which this is extracted—an article in which M. Stocks gives an authentic account of the muddle into which the German Government got the supply of corn when it attempted to regulate the price directly and without establishing a system of rations to check consumption.

I hope that the delay in the announcement of the rashly-

promised scheme for regulating coal prices means that you have realized the impolicy of taking any such action as was foreshadowed. The root of trouble, as found by the other and infinitely superior Committee, the Coal Mining Organization Committee, is a diminution of supply unaccompanied by a change in the demand.

You can scarcely be hoping to increase the supply by keeping down the price.

I have indeed met a member of Parliament who thought that high price encouraged mine-owners to produce little coal, but outside political circles at any rate, it is well recognized that rise of price encourages people to produce more, and as a matter of fact the Coal Mining Organization Committee found that last winter's high price drew in about fifty thousand men to the mines to supply partially the place of those who had enlisted.

We may take it that less than the usual quantity will certainly be produced, and I suppose it must be fairly obvious that if less is produced, somebody or other must consume less, *whatever the price may be.*

Now when the supply of an article is shorter than usual, and the demand is unchanged, the ordinary means by which the consumption is reduced to the level of the supply is a higher price, which knocks off some of the purchases. For example, last winter the high price of coal caused me to cut down my consumption, which is largely luxurious, by one ton in five, and this was a very common experience in well-to-do but not extravagant households: it also caused a manufacturer to write to the papers saying that if the price continued so high, he would have to stop work, *because he was producing an article "the price of which could not be raised,"* i.e., it was an article which could easily be dispensed with, and the labour employed in making it could with advantage be transferred to satisfy more urgent needs.

You propose to take away this salutary check on consumption so far as you can, and to put nothing in its place, except perhaps a mild exhortation such as you issued with regard to the consumption of meat, when you asked each person (including the babe in arms) to cut down his consumption of meat by 2 lb. a month. Supposing your regulations were not evaded (as happily they can and will be), whose consumption would be

reduced to meet the shortage of supply—the shortage which is inevitable and would be greater under your regulations? Not mine, and not that of the manufacturer who produced the unnecessary articles: if you keep prices down for us we shall keep on buying by the ton and the hundred tons and paying our bills punctually. No doubt the coalowners and the merchants would serve us first; it would be the people who buy by the half-hundredweight and the people who find difficulty in paying their bills that would find it difficult to get coal. And yet this preposterous scheme is put forward in the interest of the poor!

If you really "must do something" to keep down the price of this one commodity, take the opportunity of adopting "daylight saving" next summer, stop local authorities wasting half a million tons of coal per annum in unnecessary lighting of the street in the small hours, ask well-to-do people to reduce their consumption by 20 per cent., and get the King and his ministers to set the example, but don't go back to the methods of the Middle Ages which have just been tried and found impossible in Germany.

V

WHY THE INSTITUTION OF PROPERTY IS MAINTAINED

[A letter to Dr. Scott Nearing, University of Pennsylvania, who had dedicated his book, *Income: An Examination of the Returns for Services Rendered and from Property Owned in the United States*, 1915, "to three men who grasp the real significance of the conflict between service and property income—Joseph E. Cohen, J. A. Hobson, Edwin Cannan."]

July 18, 1915.

DEAR DR. SCOTT NEARING,—

. . . .

I have read the book with great interest and equal disagreement. I do not know whether you have ever read my *Economic Outlook*. . . . It shows that I have never swerved from the advocacy of the nearest possible approximation to distribution according to need, and have always looked on distribution according to service as a chimera, and an undesirable chimera.

Marshall tells us that Vanderbilt, "who evolved the New York Central Railroad system out of chaos, probably saved to the people of the United States more than he accumulated himself," meaning doubtless by this awkward statement (which confines the benefit of the U.S. railroads to the U.S. and suggests that Vanderbilt was not one of the people of the U.S.), that Vanderbilt's services were probably worth more to the world than was paid for them. J. B. Clark would say that their value was just what was paid for them, which no doubt is true, and couldn't be otherwise, value meaning what it does. Ricardo, Marx, and you carefully ignore the different kinds of labour. Labour is to you, as I think Marx says, "a homogeneous mass." An hour spent in the labour of discovering radium, an hour spent in hop-picking, an hour spent in muddling a business, an hour spent in putting one straight, are all the same. The world would have been in a chronic state of bankruptcy if it had tried to pay on the principle suggested by Marshall in Vanderbilt's case. Pay people the full equivalent of their services! Why, we shouldn't yet have paid off the discoverer of fire or the inventor of the wheel, to say nothing of such triflers as the reorganizers of railroad systems. Your and Marx's system doesn't seem much more promising. As a practical man, J B. Clark holds the field, for his system at any rate works. The world can give the labourer the whole produce of his labour *in Clark's sense* and yet continue to live and even improve its condition.

But of course Clarkism is absurd in implying that because people get the full produce of their labour in the sense of the full value as settled by existing institutions, therefore those institutions must be the best possible conceivable. There is great possibility of gradual (which does not necessarily mean very slow) improvement. The worst-paid kinds of labour may be diminished in quantity so as to make their value rise, and the higher-paid increased in quantity so as to make their value fall: the sick, the infirm, and the disabled may be better provided for: the wasteful inequality resulting from the chances of inheritance may be very much diminished, all without any catastrophic overturn and reconstruction such as history teaches to be unlikely.

Mere wailing about the large share taken by property seems to me very pernicious. I suppose it is somewhere between a

third and a half. But what of that if it were properly distributed? You say (p. 109) that it is "immaterial" to whom property-income goes and among how many it is shared. Immaterial! So it would be all the same whether all the property in the world belonged to the Kaiser or was so divided that every man, woman, and child had an equal share? On page 196 you seemed to be shocked because part of the income from property goes to "children and disabled persons": why, what better destination could be found for it? Children and others incapable of working must be maintained somehow, and if, as you say on page 109, the income from property is "a tax on industry and on society" (i.e., I suppose on that part of society which hasn't got the average amount of property), the maintenance of those who cannot work seems a very good purpose on which to expend the proceeds of the tax. Would you feel the same about property if there were none except that which belongs to universities, schools, hospitals and asylums? In the paragraph beginning at the bottom of page 109, you yourself abandon the "immaterial" contention when you endeavour to strengthen the case against property by insisting on the inequality of its distribution.

Income according to service is almost obviously a hopelessly rotten ideal, since it means *nothing* for those who, temporarily or permanently, cannot serve at all, and these in many cases are the very people whose needs are greatest. We maintain the principle of *earnings* according to service, or rather value of service, in order to make people work more effectively than they would under any other inducement at present known and available: and we maintain the institution of property (with its inevitable result of income derived from property) because we don't at present see how to pay people according to service without allowing them to acquire property, and because most of us realize that individual ownership means better management in the interests of the whole community than management by our present petty national authorities (which cannot even avoid going to war with each other when no one wants them to), as well as because property-owners like their position and most of those who have no property scarcely think it "right" to deprive them of it.

Much is being done, and much more could be done, to improve

distribution, making it more in accordance with need, but mere railing at what has been and still is an absolutely essential institution without the least suggestion of something better to take its place can do no good, and in fact does much harm. Reformers do not require to be further excited against existing organization, but rather to understand its good points better than they do, so that they may know better where it wants emendation and where it had better be left alone, for the present at any rate.

In reading the book I have noted a few details which seem particularly misleading.

Pages 2, 3. Clarkism may be absurd in its implications, but it is surely better than treating the rent paid by a tenant as part of the product of HIS effort. If I make a (net) income of £500 a year by renting a shop in a good situation for which I have to pay £1,000 a year, and you make the same income by renting a shop in a less good situation at £100 a year, am I producing something worth £1,500 a year while you are only producing something worth £600? Or if you work a farm producing a thousand bushels of some commodity, and after some years the price of the commodity rises so that you can pay a higher rent and yet be equally well off while still producing only a thousand bushels, are you producing more, or, to speak by the book, is "the product of your effort greater"? It is clearly most misleading to represent rent as paid at the expense of the tenant, or even at the expense of the whole body of tenants: you might just as well represent wages as paid at the expense of the profit-making employer. I wonder, too, that you use Ricardo's reproach, "it is only because of the scarcity of fertile land that rent is paid." Surely it has long been an economic commonplace that it is only owing to the scarcity of anything that it has a value. "Rent," you say, "can exist only where the amount of desirable land is limited." May I not say the same of wages? "Wages can exist only where the amount of desirable labour is limited." A sufficient amount of labour of any particular kind would reduce the value of the produce of, and the wages of, that labour to *nil*, and an infinite amount of labour of all kinds would do the same for all labour.

Page 11. It is a gross misuse of language to talk of monopoly —only selling—when there is no only seller but a number of

sellers acting in competition with one another. You are apparently satisfied to use the term monopoly whenever all the sellers of a commodity are the only sellers of it: at which rate everything is monopolized.

Page 12. Surely air and sunshine are let with land and do have a value.

Page 13. It may be true that neither the gram of radium nor the ton of iron "have assisted in production," but surely the gram of radium is going to be a lot more useful than the ton of iron—society can do without one of its tons of iron a great deal better than it can do without one of its grams of radium. Have Jevons and the Austrians written in vain?

Page 16. If there is much in the theory that the individual worker bargaining with a big employer is at a "woeful disadvantage," it is curious that even in the absence of labour combinations there is such a hankering after employment by the big employers in preference to employment by the small ones.

Page 19, top par. [" A definite relation exists in all primitive societies between the expenditure of energy and the income derived as a result of such energy expenditure. The clever hunter came home with game. The dexterous woman had mats and leather shirts to show for her toil. Even the spoils of war were hard-earned. They represented privation and exertion of the most extreme kind."] You might add " and when the worker had acquired these things or, say, a house, by his privation and toil, he had acquired property, and began to draw from it the same advantages as are drawn at present."

Page 26. The middle class, which draws income appreciably from both sources, may not be large in the U.S., but it is in some countries, especially France and the Low Countries, and I imagine it is growing very rapidly in most western European countries.

Pages 106–7. Are you going so to arrange matters so that all the income at present received by owners shall go to the more poorly paid workers? If it is only going to be given to all workers as an equal percentage addition to their wages, it won't be much to the poorest—not nearly as much as might be got by more promising means. Besides, aren't you going to do anything for the "tenant" of pages 2–3, who is at present, according to you, done out of part of his product?

Page 158. If miscalled "societies," the territorial authorities,

hadn't wasted so much in preparation for wars and on wars themselves, the rate of interest would have gone on falling all right. Part of the rise is fictitious, being merely due to reckoning in a depreciating medium (*vide* Irving Fisher). You don't say that property is receiving a growing proportion: Bowley thinks it is, since the beginning of the century, but that is a very short bit, and may be temporary. It isn't the "property owner" who benefits by higher rate of interest: the capital value depreciates correspondingly: it is the money-owner and the saver, and the saver is often a worker.

Pages 159–165. This priority and stability of property income seems to me a mare's nest. The people who contract for a fixed income in rent or interest naturally get it so long as the other property-owners who have contracted to pay remain solvent: but the fact that they get it makes the income of the others just that much more fluctuating. It is a notorious commonplace, and none the less true for being one, that profits fluctuate far more wildly than wages—why, for a year or several years together they are often minus quantities, losses, and who ever heard of minus wages, i.e., of the employees of a business going without wages and paying something in to keep the business going? One of the best points about the "capitalistic" or profit-making system is just that profit does take the ups and downs and the inevitable differences between the successful and unsuccessful business: it is only productive-co-operationists and profit-sharing enthusiasts who want to do away with the very good arrangement by which the income of the worker is made independent of the fortunes of the particular business in which he is employed, though it is not independent of the fortunes of the whole trade.

The "smoothing" of dividend fluctuations by paying less than profits in good years and more than profits in bad (referred to page 160 and page 164) makes no real difference: why not smooth between years as well as between months? If my investment really yields in five years £60, £0, £30, £50 and £10, and I have no other investments which fluctuate in a counterbalancing direction, it may save me a trifling amount of thought about what my expenditure ought to be when the company declares a steady dividend yielding me £30 per annum, but, being a careful man, I shall be worried in the second and fifth

years by the inevitable comment that the dividend has not been earned. On the whole I think I prefer to do my own smoothing.

Fluctuating service income can be smoothed in the same way —by banking the surplus of good years and spending it in bad.

Page 189 takes a topsy-turvy view. I take it that the Commissions in your country were intended to *reduce* the gains of certain corporations, and have at any rate tried to do so. They were not intended to reduce profits to *nil*, and so they had to fix upon some standard down to which to reduce them. You treat this standard as if the Commissions had been sent out to bring the gains of corporations which were not making so much *up* to that standard! It will be news to me to learn that the Commissions have been endeavouring to improve the earnings of the bankrupt and low-paying concerns.

So far as I can judge from what reaches me here, the principle which is beginning to be recognized in U.S. legislation and commission decisions is the very sound one that the return from regulated monopolies should be such, and such only, as to secure a proper amount of investment of capital in them over an indefinitely prolonged period. And a mistake often made about this principle is to suppose that you can secure it by preventing any corporation making more than the *average* return. In order to secure sufficient investment the lucky must be allowed to make more than the sufficient average, so as to balance the unlucky.

Pages 178–9 don't impress me at all. Did anyone ever doubt that the possession of property was an economic advantage to the possessor? As things are, it is well that it is so, since the bottom would be knocked out of existing organization if it were not. If you have any plan for making things different from what they are in such a way that we can do without some or all of our existing institutions, in God's name bring it forward and let us examine it and see whether there is any probability of its doing what you claim for it. Meantime cease from aggravating perfectly futile discontent with wild whirling words about "economic justice" (p. 201). (Do "idlers and wastrels" usually have such a good time? Among my acquaintance I should certainly say that the industrious and thrifty have got on much better.) As I often tell my classes, justice is cried for by children, pagans and barbarians. What we have to do is

not what such people call just, but what we find to be best. Fortunately the popular idea of justice soon manages to accommodate itself to what is proved to be best in the circumstances of the moment, and on the whole it declines the socialist invitation to classify the honest owner of property and man of business with the thief and the swindler (page 202, taken in conjunction with the rest of the book).

Well, I have given you a good scolding, just as if your book was an essay submitted by one of my pupils. But you must excuse my freedom: it isn't every day that I have a book dedicated to me.

VI

AGAINST A SUBSIDY FOR HOME-GROWN WHEAT

[In July, 1915, my friend Professor Bastable sent me without any explanation the question printed below. My answer, which follows, was dated July 28. The plan suggested by the question was adopted by Parliament in the Corn Production Act, 1917, and abandoned in 1921.

Question: What would be the effects of fixing a minimum price for wheat grown in the United Kingdom?

I take it the minimum price intended in this question is not quite of the same character as the minimum prices at present fixed for certain securities on the Stock Exchange. The Stock Exchange regulation forbids the sale of these securities at prices below the minima. The obvious consequence is that when purchasers are not willing to give so much, the securities remain in the hands of the present holders, however much these holders may desire to sell for what they could get. Apply this plan to British wheat and you would shortly extinguish its production altogether except in so far as the farmers could consume their own wheat. For whenever the price of imported wheat was below the minimum, no one would buy British wheat and the farmers would have it left on their hands.

What is meant is probably that the British taxpayer should undertake to make up to the British farmer the difference between a fixed price to be called "the minimum price" and the actual price at which he sells, whenever the latter is less than

the former. We may suppose, of course, that no attempt would be made to give the precise difference in each individual case, as this would clearly lead to endless and enormous fraud: the difference would be an average difference as calculated by the Board of Agriculture, and would be paid to individual farmers in proportion to the amount sold by each.

The proposal may therefore be properly described as a proposal for giving a varying bounty on the production of wheat in the United Kingdom, the variation being so arranged as to secure that British farmers would in the aggregate receive either from the purchasers or from the purchasers and the taxpayers together not less than the "minimum price."

The effects would of course vary in magnitude with the height of the price chosen for the "minimum," but would be the same in character whatever its amount.

The farmers would in the long run get a higher sum of money for each bushel of wheat sold. This would cause more wheat to be sown, more labour, etc., to be expended on what was sown, and a certain encroachment of wheat-growing upon other kinds of agriculture. The increase in the amount of wheat grown, though it might be considerable in relation to the amount at present grown in the U.K., would be a mere trifle in relation to the wheat grown in the world at large, and could not possibly cause more than an inappreciable fall in the world-price. Consumers, therefore, would receive no appreciable benefit from the greater quantity of wheat grown in the U.K., while they would probably suffer something appreciable owing to the encroachment of corn-growing on other kinds of agricultural production, since this might not be confined to those kinds which can easily be replaced by greater importation. There might, for example, be an appreciable rise in the price of milk.

Farmers in the U.K. would, of course, gain something on the first imposition of the scheme, but all bounties eventually attract sufficient competition to wipe out the extra profits obtained in a trade to which they are granted. Without knowing how the money for the bounty is to be raised it is impossible for anyone to say what proportion of the extra profits would slip away in increased rent and what in increased cost of labour owing to the necessity of retaining and possibly increasing the number of agricultural workers in face of the fact that the inhabitants of

the country would have to pay additional taxation for something which in no way increased its advantages as a place of residence.

The polemical free traders of the earlier part of the nineteenth century would have said that the whole amount levied from the taxpayers would go straight into the pockets of the landlords. This was the line which they took when the agricultural interest of 100 years ago demanded a minimum price of 80*s.* the quarter and the legislature attempted to give it by regulation of importation. But I think they were wrong. Doubtless some owners of land would benefit, but others would lose just as much, if not more. It would really be perfectly absurd to contend that the aggregate value of all land, urban as well as rural, in the U.K. would be anything like what it is to-day if the corn laws of 1816 had continued in force to the present time. You cannot raise the value of the land of a country by making that country a dear place to live in, whether the dearness is caused by protection or by taxation. In my opinion such a bounty as is proposed would not go straight into the pockets of the landlords: it would be simply wasted—thrown away in paying for a less efficient distribution of the agriculture of the world.

VII

CAN CAPITAL BE "REALIZED" TO PAY FOR CARRYING ON THE WAR?

[In some form or other the belief criticized in the following letter to a friend was very widespread.]

October 24, 1915.

Dear ——,

—— has gone as mad as a hatter, and what's worse, says you agree with him. He can't see that in the absence of outside buyers or lenders who will send something into the country in exchange for a right to income from it in the future, there is no way by which we can "realize" for warlike purposes things which are themselves incapable of being applied to such purposes. He calls such things "wealth," which is very helpful when the object is to forget what they really are—houses, reaping-machines, etc.—and then asks, "Do you mean to say your accumu-

lated wealth is no use to you in an emergency ? " and when I say " Yes, certainly, because no process of juggling with the currency and war loans can possibly turn an asphalt road in Oxford into a trench in the Dardanelles, or a college barge into a submarine," he says " that's pure dogmatism."

It is pretty obvious that the amount of power which can be put into a war is determined by the amount of labour and machinery available for the purpose, and the Treasury doctrine (presumably taught them by Withers) that the money which can be applied to the purpose must come from income is only putting the truth into financial language, assuming that everything has to be paid for.

The only real difficulty in comprehending the actual situation seems to arise from the paradoxical fact that the national income has greatly risen. With a smattering of economics people are apt to say " it must have decreased in consequence of the withdrawal of men and machinery from productive industry." But they are not withdrawn—they are only producing mud and blood in Flanders instead of houses, etc., here—and, taking the whole population together, you find there is far more work doing than usual: why, even David and I have been digging potatoes which were put in and were to have been got out by the unemployed, and this is typical. More effort is being put out, and all of it is valued higher, in consequence of the depreciation of the currency of the world by the paper issues. Consequently the total income measured in the usual way by money has increased many hundred millions, and the amount of money which can be applied to the war is much greater than would be suggested by looking at income and savings as they were *before* the war. But it remains true that I can't sell my house, or borrow on it, and hand the proceeds to McKenna unless I can find a buyer or a lender, and that no buyer or lender can be found except one who has either got spare income or has found another buyer or lender from whom he has raised the money.

As far as I can make out, —— proposes that the Government should lend to my bank sufficient funds to enable it to lend money on my house to me, but I can't make out where he supposes the Government, which by hypothesis is in want of money, gets the funds from, or what the use of lending money in order to

borrow it again is. He seems hurt when I suggest that he proposes to get it by the issue of inconvertible and depreciating notes.

VIII

HOW TO GET CONTRIBUTIONS FROM SMALL SAVERS

[A letter to Mr. H. J. (now Sir Halford) Mackinder, who was at that time a member of a committee charged with the duty of collecting small savings for the carrying on of the War. I think the plan suggested would have been much better than the one pound War Savings Certificate scheme soon afterwards adopted, under which 5 per cent. free of income-tax and super-tax with a limit of 500 for each person was offered. The freedom from tax made these certificates a very attractive investment for persons who would in its absence have subscribed for the ordinary loans subject to taxation, especially as they could take up 500 for their wives as well as themselves. The Committees in estimating how much was taken up by such persons were in the habit of reckoning only the holdings of 500 taken up all at the same time, but this grossly underestimated the amount, as it was quite common for well-to-do persons to take up their 500 in two or three instalments, or for some reason or other to have an odd amount less than 500.

Legislation (10 Geo. V. ch. 12) providing for a suspension of the limits to savings bank deposits mentioned in the last paragraph, was being carried through when the letter was written, and the Savings Bank Act, 1920, abolished them.

December 12, 1915.

DEAR MACKINDER,—

When one of the War loans was coming out, the person who writes "Answers to Correspondents" in the *Daily Chronicle* produced something nearly in these words:—

"You are under a misapprehension; your money in the savings bank is not lent to the Government, and cannot be used for the war."

Startled by so gross a misstatement coming from what professes to be a source of information, I have kept my eyes open for any authoritative intimation that anyone desirous of giving the Government financial assistance in a small way could not possibly do better than put or keep his money in the Post Office or Trustee Savings Banks. I do not think any has been forthcoming until the letter of the Controller to that figment, "a

correspondent,'' appeared in the newspapers a few days ago. In these days of poster appeals I think something much more flamboyant than that is required. I should display in all and so far as possible, outside all post offices, something like this :—

MONEY IN THE SAVINGS BANK IS LENT TO THE GOVERNMENT AND HELPS TO CARRY ON THE WAR. PUT MORE IN. PUT SOMETHING IN ONCE A WEEK.

Or, if it is supposed that such a notice might frighten some depositors, try—

PUT MORE MONEY IN THE SAVINGS BANK AND HELP YOUR COUNTRY IN THE WAR.

Legislation would not be necessary for that, nor, I suppose, for some encouragement and help by way of a small commission to collecting societies. Are not there a lot of agencies collecting for various purposes at present which could without appreciable increase of expense collect savings for deposit in the local post offices at the same time—of course only so long as it could be held a patriotic duty, since in an ordinary way the depositing would probably compete with the agencies' primary objects.

I suppose it is true that the great mass of savings-bank depositors are not much influenced by the rate of interest paid, but is not this largely due to the fact that the interest paid has always been so low that it is only people to whom interest was no object who have cared to put their money in ? And I think there is evidence that the Savings Bank has in fact been much more attractive when the market rate of interest outside has been not much above it than when it has been high above it. Moreover, the expense of giving 4 per cent. on *additional* deposits made during the war would be absolutely trifling if it attracted nothing, and if it did attract anything, it would be such extraordinarily good business compared to War Loans that it would be worth doing even if the sum obtained were not very large. I suggest, therefore, that something to this effect should be added to the notice given above :—

A BONUS WILL BE PAID ON WAR DEPOSITS.

A depositor who increases his deposit beyond the amount belonging to him on December 10, 1915 (or later convenient date

prior to public knowledge of the matter), will be paid a bonus of interest at the rate of 4*d.* in the pound per annum (in addition to the usual 6*d.* in the pound) on the excess. A new depositor will be paid a similar bonus on the whole amount belonging to him. Provided in both cases that if more than £10 is deposited in any one calendar month, the excess over £10 shall receive only the usual 6*d.* in the pound.

The limits of £50 deposit in any one calendar year and £200 in all are suspended."

The limits of £50 and £200 are well known to be most pernicious—constantly leading to the loss of sums received as legacies and so on—and have no justification when the rate of interest in the Savings Bank is much below the rate outside. But if 4 per cent. were paid, some restriction would be necessary to prevent wholesale withdrawals from the ordinary banks. It seems to me that a restriction of monthly amount would do all that was required, and not stand in the way of but rather suggest the kind of weekly deposits which it is most desired to catch.

IX

HOW TO ARGUE AGAINST CA' CANNY

[An answer to a letter from a correspondent asking how he should advise some one else who had been asked to tell Tyneside employers what to say when they were obstructed by their employees' fear of producing too much.]

December 16, 1915.

Dear Sir,—

I think the reply to Mr. —— should be that he had better advise the employers to appeal to the men's love of their country or, more profitably perhaps, to their hatred of the enemy, rather than to their self or union interest.

There is no difficulty in showing that small output per person is bad for the community and for the working-classes who compose the major part of the community, but while this appeals to the good socialist, it has little influence upon the trade-unionist. Him you require to convince that it is bad for "the trade." He has not thought out the question of what persons the trade

consists, but decides whether a thing is good or bad for the trade simply by its effect on weekly wages. Now in certain conditions of elasticity of demand for a particular product, the rise of price caused by limitation of output is likely to cause such a falling off of demand that it will reduce wages almost immediately. But this is certainly not so with the things now being produced on the Tyne. All that can be said is that though the policy will pay those who resort to it during the continuance of the war, it will tend towards reduction of earnings after the end of it because it will have caused the introduction of larger numbers of new workers into the trades concerned, and the competition of these persons will be very depressing. But it seems to me that it is by no means desirable to draw attention to this fact: it might only lead to more obstruction being offered to the introduction of these additional workers, and the difficulties thus caused might well be worse than the present ones.

Inter arma silent leges is not to be translated "In time of war economic laws don't work," but rather "In time of war it is sometimes well to be silent about economic laws."

X

WHICH SHALL WE HAVE ? REAL PEACE, OR A SACRIFICE OF EVERYTHING TO PREPARATION FOR THE NEXT WAR ?

[A review-article in the *Economic Journal* for December, 1915, on F. W. Hirst's *Political Economy of War*, 1915.

A reader may object that in fact we have not been compelled to make the choice indicated: the nations have not united, and yet they have not given up everything to preparation for the next war. The answer is that as yet they are only playing at preparation: if they once start in earnest they will soon find that the choice is what the article suggests.]

"THE political economy of war" might well be regarded as a contradiction in terms. Political economy suggests an orderly state of things in which the different members of the societary "household" co-operate in peace, while war is the active manifestation of the anarchy which the human race persists in maintaining by its blind folly in continuing the existence of absolutely

sovereign states recognizing no common authority. Mr. Hirst complains that no economist of the first rank "has made any comprehensive inquiry into the economics of modern warfare." The defence of the economist is, or should be, that warfare, whether modern or ancient, is outside the pale of economics. No one imagines a political economy of civil war; no more ought anyone to ask for the political economy of the better-organized and, under modern conditions, infinitely more destructive warfare between "countries" which have the misfortune to have independent governments, and imagine themselves to have different economic interests which they would never even have conceived to exist in the absence of such independence with its paraphernalia of separate military forces and diplomatic agencies. Where the ordinary economists have been to blame is not in ignoring war, but in their careless habit of saying "the country" where they really mean the world, "the nation" where they really mean society at large, and "national" where they really mean "human." Their excuse is, of course, that in the gradual development of economic thought, with its progress from the individual to a larger standpoint, it was more convenient at one time to suppose an isolated country and treat it as a type of society than to treat directly of society as a whole. But this is only an excuse, not a justification, and the excuse loses more and more of its force as time goes on, and countries become less and less isolated in fact. The practice is now intensely harmful, especially because it suggests a conception of different countries as watertight compartments and a conception of trade as a kind of pumping machinery which draws water from one of these into another to the disadvantage of all the inhabitants of the one and the advantage of all the inhabitants of the other. Much more blameworthy, however, are those economic historians whose laudable desire to understand the past has ended in blind admiration for national policies which were inspired by ignorant jealousies and based on stupid misconceptions.

Mr. Hirst does not, as he might have done, attempt to put either of these classes right, but confines himself rather to enlarging on the cost of war in the past and present, with some very gloomy but vague suggestions as to the future if we do not amend our ways. The amendment he seems to look for in the direction of a return to insularity on the part of this country, moderation in

armaments, and the international adoption of regulations tending to make war at sea less destructive.

> "What," he says, "will be the condition of Europe, when peace comes through exhaustion, after the Continental States have used up all their credit and borrowed all that can be borrowed, may be left to the imagination of those who can see further than the writer through the gathering gloom. How commerce will be financed, how manufactures will be revived, how banking will be carried on, how public bankruptcies on an unheard-of scale are to be avoided—these are questions which defy experience and baffle even the wisest heads."

This is surely a very mild picture of the wrath to come if Europe does not amend her ways on the conclusion of peace. In that case, what all the countries will have to do is to consider how to prepare for the next war. Now before the present war most people had a belief that a very moderate amount of preparation was adequate. The most violent militarist, given *carte blanche*, would have said a tenth of the national income would be ample. Now we know better. "Munitions" are no longer a bow or a rifle for each man and strictly limited amounts of a few other things, but a mass of warlike provision which may indeed be required only in limited amounts so far as parts of it are concerned, but which, as a whole, is absolutely unlimited. Moreover, most of the appliances required are susceptible of improvement by invention, so that the existing stock is constantly becoming obsolete and unfit for use against an enemy provided with newer appliances. And lastly, an enormous advantage accrues to the party which can invent new appliances and keep the secret after they are ready. The consequence is that no Government will ever in future be able to say: "We have done all we can" until it has ground its subjects down to the barest necessaries of life. Readers of Mr. Keynes' review in the last *Economic Journal* (Sept. 1915) will know how little terror Mr. Hirst's picture would have for Professor Jaffé. Perish commerce! he would say, it chiefly supplies unnecessary luxuries and introduces pernicious foreign ideas. Manufactures? What are required which the Government arsenals will not supply? Banking? If any is necessary, the State can carry it on. National bankruptcies? What matter? The holders of national obligations have at present a surplus income which must be acquired by the

State, and it is all the same whether it is acquired by taxation or by repudiation. How shall we borrow in the next war? As no one will have any surplus income over mere necessaries, we shall not expect to be able to borrow, but we shall have got all we can in any case.

We had fondly imagined that barbarians had to give a larger proportion of their time and energy to war than civilized people. Now we find that this is all a mistake. The barbarians, with their much smaller command over natural forces, were obliged to spend a very large part of their time and labour in providing themselves with the bare necessaries of life. On occasion they could put a large percentage of their total population in the battlefield for a short time, but they could not keep a large proportion continually engaged in warlike preparations. We can, because we have a much greater margin of power. Six great countries are at present just beginning to realize how easily an appreciable part of this margin may be diverted from its old employment of providing the comforts and refinements of life to the manufacture of munitions and other war services. "Give him time," says the Minister of Finance, "and the taxpayer will be able to cut down his private expenditure so as to be able to meet the greater demands of the State." It is perfectly true down to a certain limit, and that limit is simply the bare necessaries of life, which, with modern knowledge and appliances, can be provided with a very small proportion of the aggregate available labour.

That man will permanently submit to having his definition changed to "a munition-making animal" it is fortunately absurd to suppose; the only difficulty is to foresee exactly what way out he will take. One thing is certain: the policy of bloated national armaments as "insurance" (save the mark!) against war, and the policy of moderation in national armaments, are alike hopelessly discredited. Order cannot be maintained without force, it is true, but force must be economized, and the only way to economize it is for that large part of the world which desires peace and quiet to unite in maintaining sufficient force to defend itself against the small part which desires something else. The large part doubtless comprises more than four-fifths of the whole, but if it were only four-fifths it would be safe if it only devoted about a quarter of its possible maximum effort to defence when the other part was

united and putting out its whole possible effort for aggression. The governing classes of the different countries are doubtless unprepared at the moment to surrender to a federation or even an alliance the most cherished feature of national independence, the right to make war (although several countries have surrendered for the present the right to make peace). But if they persist in their present attitude they will find themselves very soon between the devil and the deep sea; their choice will lie between taxing themselves out of existence in order to maintain the cherished right on the one hand, and on the other being swept away, along with the national organizations which they have misdirected, by a furious uprising of the multitude against intolerable burdens. The decision will come somewhat suddenly when, at the end of the war, the different Governments have to provide taxes to yield an addition of more than 50 per cent. to the ante-bellum revenue in order merely to cover interest on the new debt and pensions, as well as a much larger and indeed indefinitely large addition for the reorganization, re-equipment, and extension of military and naval forces. Mr. Hirst's history shows Europeans sitting down after the conclusion of each war with great relief and a pious hope that it would not occur again for a long time. The futility of this course may not even now be as obvious to all as it should be, but the immense change in the technique of war will make it practically impossible.

1916

I

MERCANTILE WAR TO SUCCEED MILITARY WAR?

[A review-article which appeared in the *Economic Journal* for March, 1916, on the "Report of a Sub-committee of the Advisory Committee to the Board of Trade on Commercial Intelligence with respect to measures for securing the position, after the War, of certain branches of British Industry" (Cd. 8181). It brought me an abusive letter from New Zealand, referring to "free traders *alias* pro-Germans," and enclosing a cutting from the *Auckland Star* for July 6, which ends with the assertion, "Even if the Allies gain an overwhelming triumph, the main purposes of the war will not have been achieved if we do not force the Germans to expiate their guilt by imposing on them, at least in the sphere of commerce, a sentence of outlawry and ostracism, to be maintained so long as may seem necessary for the safety and well-being of the rest of mankind."]

THIS report is signed "Algernon E. Firth, A. J. Hobson, Stanley Machin, E. Parkes, Albert Spicer," the last-named, however, appending a reservation indicating that he is not prepared to swallow the whole of the Protectionist proposals of his colleagues. The President of the Board of Trade publishes the document "without, of course, taking responsibility for any of its conclusions," which is a little like the conduct of the proverbial father who introduces his unattractive son to the schoolmaster with a hint about the unpleasant hereditary characteristics of the boy's mother's family. If the President did not select the Sub-committee, he must at any rate have selected the Committee.

Like many another modern politician, pathetically endeavouring to be "efficient" under the lash of the daily journalist, who despises thought because he has no time for it, the President has displayed an unfortunate readiness to start an inquiry how something is to be done without first asking whether it is desirable to do it.

Early in the present conflict the Board of Trade allowed itself

to be rushed by newspaper agitation into giving countenance to what was called the "war on German trade," by which was meant not the operations of the Allies' navies, armies, and custom houses during the war, but a movement in the direction of producing in this country every kind of manufacture hitherto exported from Germany, whether important or unimportant, whether likely to afford lucrative employment or starvation wages. Some measure of success having been attained in this, it is supposed necessary to appoint a Sub-committee "to make recommendations as to the best means of securing the position, after the War, of industries undertaken in consequence of the Exchange meetings and the British Industries Fair organized by the Board of Trade." Precisely what industries have actually been undertaken in consequence of this unusual—perhaps fortunately unusual—activity of the Board of Trade we are not told. The Sub-committee say:

"The following were the branches of industry to which it appeared that our inquiries could most usefully be directed, having regard to the terms of our reference:—Paper manufacture, the printing trade (including colour printing), the stationery trade, the jewellers' and silversmiths' trade, cutlery, fancy leather goods, glassware (including table glass, laboratory ware and glass bottles), china and earthenware, toys, electrical apparatus, brush, etc., trade, hardware."

We can scarcely be expected to believe that the efforts of the Board of Trade caused new industries to be undertaken in all these branches of manufacture, and we notice that the Sub-committee's circular letter of inquiry speaks of "possible measures for assisting British manufacturers to maintain, after the conclusion of the present war, such new developments of industry *as they may have undertaken in consequence of present conditions*," not such as they have undertaken in consequence of the measures taken by the Board of Trade. Further on the letter becomes even wider in scope. It asks for observations on assistance to scientific research; on copyright and patent law, trade-marks and merchandise marks, transport, finance, and trade fairs and exhibitions; and then expresses readiness to receive suggestions of a general character "in regard to such matters as the conditions under which, prior to the war, the manufacture of" articles in which the addressees were interested "was carried on in this country, in competition with Germany

and Austria-Hungary, and any special difficulties which that competition encountered." The inquiry thus gets completely away from its original purpose, and becomes little more than an invitation to persons carrying on particular trades to say how they would like the Government to assist them in competing with persons carrying on those trades in Germany and Austria-Hungary. Even this is not wide enough for the Sub-committee; it actually proceeds to receive the complaints of the printers against the copyright law of the United States and agrees to their proposal that our own law should be assimilated to it, which would not affect German and Austrian competition in the least degree.

A very natural consequence of the Sub-committee's methods was that all the particular matters on which it asked for guidance were "regarded as of secondary importance in comparison with one question, and that is the possibility or otherwise of tariff protection after the war. Practically all the representative firms and associations consulted by us asked for a measure of protection." Why? The effects of the war are given as a reason in section 49, which recalls the fears felt by the agriculturists in 1814 and their successful demand for a higher protection against the disastrous foreign competition which they imagined would ruin them on the conclusion of peace:—

"There is a general fear that, immediately after the war, this country will be flooded with German and Austro-Hungarian goods, sold at almost any price, and that the competition in price which was going on before the war will be accentuated, with resultant serious difficulty to all manufacturers of goods of kinds (*sic*) exposed to this competition, and positive disaster to those manufacturers who have been encouraged to extend their operations or engage in new branches of industry with a view to capturing trade hitherto carried on by enemy countries."

This fear is said to be based on two beliefs, firstly, that large stocks of some things have been accumulated, which the Sub-committee evidently doubts, and secondly, that Germany "will make every effort to recover her position in the world's markets and to crush nascent competition, and that in carrying out that policy cheapness will be a potent weapon," which the Sub-committee accepts. The possibility of the British manufacturers making every effort to retain their newly-gained position and to

crush renascent competition, and of their using cheapness as a weapon in the conflict, does not seem to have crossed the mind of the Sub-committee. It is strange that in these days, when everything is scarce and dear and the populace of all Europe cries out against its futile Governments because they do not keep prices down, there should be found even a Board of Trade Sub-committee so old-fashioned as to believe that plenty and cheapness are the evils against which we must be on our guard.

But, as in 1814, the war and its cessation are by no means indispensable to the demand for Protection. "The causes of the ability"—would it not be well to think also of willingness?—" of German firms in the past to undersell their British competitors" were discussed, and "most emphasis was laid on" (*a*) the low German export railway rates and "other transport advantages," including apparently the existence of the river Rhine, (*b*) the German import duties, which enabled manufacturers to combine to sell cheaper abroad than at home, and (*c*) the low German wages per unit of work accomplished. Superior organization and greater attention to work by workmen seem to have been mentioned at least in one case as the explanation of the lower labour cost; the report does not suggest that anyone ever thought of inquiring whether the profits and salaries of business management were lower in Germany.

Now there must, of course, be some cause or causes why a particular thing is sold by the producers of one country at a lower price than producers of another country care to take, and presumably one or more of these causes must be proper and legitimate, even from the point of view of the second country; otherwise, in a world in which each country's affairs were well ordered by its Government international trade would cease. It would be extremely interesting to have from the Sub-committee or from some authoritative Protectionist source a definite statement of belief on the question what causes are proper and legitimate. The Sub-committee does not, indeed, say plainly that the other countries of the world ought to combine to force the German Government to charge higher railway rates on exported goods; to remove potteries from the banks of the Rhine to some district with a geographical situation more like that of Staffordshire; to prevent combinations from selling things dear to Germans and cheap to the rest of the world;

and, finally, to enact that no one in Germany shall take less wages, salary, or profit for the same kind and amount of work than the highest paid for that kind and amount of work anywhere else. But from the tone in which it discusses these matters we can safely infer that it really supposes that it would be a fine thing for the British Empire, and, indeed, the whole world outside Germany (and possibly Austria-Hungary, with perhaps Turkey and Bulgaria), if this could be done. Failing this possibility, the Sub-committee recommends indiscriminate protection :—

"15. *Tariff Protection.*—We are of opinion that where the national supply of certain manufactured articles, which are of vital importance to the national safety, or are essential to other industries, has fallen into the hands of manufacturers and traders outside this country, British manufacturers ready to undertake the manufacture of such articles in this country should be afforded sufficient tariff protection to enable them to maintain such production after the war.

"With reference to the strongly expressed opinion of many of the witnesses that the enactment of protective duties on the industries other than those referred to in the preceding paragraph, which have formed the subject of our inquiry, is essential to their maintenance, we wish to report that in view of the following considerations :—

(*a*) that there exists a strong desire to respond to the feeling in our Dominions in favour of an Imperial preference in trade, and that there is also a strong desire to arrange preferential trading with those who are our Allies in the present war, and

(*b*) that the present high direct taxation tends to raise the rate of interest on money, and cheap and abundant capital for the employment of their labour is of the greatest importance to the working-classes,

it will be necessary to impose some widely-spread import duties, and we are therefore prepared to recommend that a larger proportion of the Revenue should be raised by reasonable import duties. We are of opinion that such import duties would go a long way towards satisfying the requests for special protective treatment for the industries which we have had under consideration."

The first of these paragraphs, omitting the words "or are essential to other industries," merely embodies an old generally received "exception to the general rule of Free Trade." It was thought of in the days of ropes and sails, and is now perfectly obsolete. It is almost incredible that five men who have presumably read the newspapers during the present war could

put forward tariff protection as a means of securing the manufactured articles which may be of vital importance in the next war. Something much greater in effect than prohibition of importation, to say nothing of mere taxation of imports, will be required if the various countries are to prepare for the next war—whether in the present grouping or in some new grouping which may commend itself to the philosophical sentiment and commercial jealousies of ten years hence. Factories and trained workers will have to be kept at the call of the Government, as horses have been in recent years.

The inclusion in this paragraph of articles "essential to other industries" is amazing. There are many industries which every one admits to be unimportant not only to national safety, but also to individual comfort. Moreover, it is not always possible to make the sharp distinction between raw material and manufactured article which seems to be necessary if we are to reconcile the new doctrine of keeping out essential manufactured articles with the old doctrine of letting raw materials in.

The second paragraph is worth following carefully. It alleges that "it will be necessary" to impose duties on many imports for two reasons, between which there is the sharpest opposition. Firstly, it will be necessary because a two-step, or more probably a three-step, preferential tariff must be imposed in order to satisfy the Dominion and Allied sentiment: there must, that is, be either free admission or a very low rate for Imperial goods, a low rate for Allies' goods, and a higher rate for goods from the countries with which we are now at war and from the countries now neutral. Now it is perfectly certain that an arrangement of this kind, if it embodied rates which gave the Dominions and Allies rates (or absence of rates) likely to consolidate the Empire or the Alliance, could not produce much money; one effect, and an intended one, would be to divert trade from its old channels, increasing trade between this country and the Dominions and the Allies subject to no duties or low duties, at the expense of the trade between this country and other countries subject to the higher duties. But the suggestion of the sentence marked (*b*) and the remainder of the paragraph is that an enormous sum of money is going to be raised by this egregious tariff. It is not only to "tend" to

put cheap and abundant capital at the command of the working-classes, but is actually to be big enough to constitute "a larger proportion of the Revenue." In 1913–14 the Customs contributed 35½ millions out of a total revenue of 198¼ and a total tax revenue of 163 millions: the Committee which had to arrange a preferential tariff likely to cement the Empire and the Alliance and at the same time to produce more than 18 per cent. of the, perhaps, doubled or more than doubled revenue which will be required after the war, would certainly find itself confronted by a stiff task. It would be driven inevitably to the taxation of necessary articles of food coming from the Dominions, to say nothing of the Allies. The present Sub-committee endeavours to reconcile the working-classes to this prospect by the suggestion that if they will pay more for the things which they consume, and thereby relieve the wealthy of some direct taxation, the wealthy will save more, so that capital will be cheap and abundant, which will make employment plentiful. Was ever net spread more openly in the sight of any bird? The working-classes are often inexpert in economics, but they are not so hopelessly stupid and ignorant as to be taken in by this revival of that wage-fund theory of the eighteen-forties which has been justly ridiculed by all their advocates for seventy years. They will decline to put a penny in the slot on the assurance that the machine will eventually hand out a farthing. The comfortable people who suppose that the war is going to afford a suitable opportunity for shifting a larger proportion of the burdens imposed by the incompetence of national Governments on the backs of the working-classes are living in a fool's paradise: it is far more probable that, if the belligerents' national debts are not simply repudiated, drastic levies on property will take place throughout Europe in order to redeem them at the expense of the propertied classes, including, of course, the holders of the national securities themselves.

The individual purchaser, under the Sub-committee's proposals, is to be allowed to please himself whether he will contribute to the revenue by buying a foreign article on which a Customs duty is paid or a home-made one (at the same or a higher price) on which no duty has been paid. But the inhabitants of a locality acting collectively through their local authority,

and even the inhabitants of the whole country, acting through the national Government, are to be allowed no such liberty. Recommendation 6 (*b*) runs as follows:—

> "All Government Departments, Local Authorities, and Statutory Bodies entrusted with the control of monies raised by taxes or rates should be under legal obligation to purchase, so far as possible, only goods produced within the British Empire.
>
> "To meet exceptional cases the Board of Trade might be empowered to grant licences to Public Bodies for the purchase of foreign goods where special circumstances, including, for example, the existence of a combine or 'trust,' can be proved."

Anyone who has ever assisted at the "opening of contracts" by a local authority will smile.

Perhaps the lowest depth of all is reached in Recommendation 4, in which the Sub-committee propose a special merchandise-marks law for German and Austrian goods: these are to be marked "Made in Germany" or "Made in Austria-Hungary" without any alternative, while goods from other foreign countries are to be "similarly marked either with the country of origin or with the words, 'Foreign Made' or 'Not British.'" It is not clear whether the choice between "Foreign Made" and, say, "Made in Belgium" or "Made in Bulgaria" is to be embodied in British legislation or left to the discretion of the trader in each case; but either way the Sub-committee is dallying with an almost incredibly childish proposal for nothing but a mere petty annoyance of two countries with which a treaty of peace will have been concluded.

It might be imagined that "practical men" such as the Sub-committee was intended to consist of would realize not only that we are at war, but also that it is to most of us extremely disagreeable, and that when peace is once concluded, almost all of us will wish that peace to continue. In the heat of conflict the ordinary person says many foolish things in conversation with his family and friends, but five "practical men" assembled round a table at the Board of Trade to consider after-war problems ought to have been able to imagine how these problems will appear when peace succeeds war, and passion subsides in the breast of the victors. It will not then seem anything but sheer lunacy to offer petty insults to fallen enemies, and at the same time to do everything possible to make those fallen enemies

and the rest of the non-Ally half of the world into a single trade group economically independent of the Allies, and the best motto for an essay propounding such a policy would be, *Solvet sæclum in favilla*—our world will end in smoke and fire.

II

AN APOLOGY FOR THE EXCESS PROFITS TAX

[A letter to a friend who complained that the excess profits tax prevented him from putting more capital into his business, which was essential and was formerly largely carried on by Germans.]

March 15, 1916.

My dear S——

It isn't often that you can collect a tax with wholly good results. When you tax whisky and it makes people who take too much take less you may say you have done so, and hence the large revenue from intoxicating drinks in most countries, but this is an exception to the general rule, which is that taxation is a nuisance.

You can to a certain extent choose between taxation which will reduce consumption and taxation which will reduce savings (which mean additions to capital). The most effectual and almost the only way of taxing so as to reduce consumption rather than savings is to tax the necessaries of life and such luxuries as are consumed by the poor. Why? Because by doing so you get money out of people who don't save much in the aggregate, and therefore cannot take the taxes off their savings: whereas when you tax the wealthy, these continue to consume just as much as before and simply reduce their savings by the amount of the taxes. (This is, of course, an overstatement, but it is easier to put it in that way than to stick in a lot of "relatively" and "proportionately," etc.). Well, in ordinary times there is naturally some reluctance to tax the poor, and at present no belligerent European government dares to do it: a lot of them have suspended their duties on food, I believe. They know they are unpopular enough already for their incompetence, and so instead of taxing to curtail consumption they go about making absurd and mischievous attempts to

keep prices down, causing all sorts of troubles thereby. So they are driven on to the kinds of taxation which fall largely on savings: McKenna takes £—— a year more from me in income-tax and I have £—— a year less savings in consequence: but at any rate he can say he's better off than if he didn't raise that by taxation and had to *borrow* the £—— more from me and pay 5 per cent. on it: in fact he ought to take a great deal more in the same way.

The excess profits tax is merely an extreme case: it is levied because it is supposed it will be particularly easy for the payers to pay, as it is on an excess over their previous incomes, and therefore they can pay it without reducing their previous consumption. That of course implies that it is likely to fall on savings—additions to capital—even more entirely than increase of income-tax and super-tax. You must take this to be defended on the general grounds suggested above.

But, you say, excess profits are earned in the most important trades, and therefore instead of being specially taxed ought to be specially exempt, so that these most important trades may be properly alimented with new capital. There is something in this, but I think its importance is a good deal diminished by the Government having taken the production of munitions so much into its own hands: if it were depending simply on the market, it would be suicidal to tax the people who supplied its wants. I don't think that the fact that a particular trade was formerly carried on by Germans is a proof of its special importance—it would be difficult to think so when confronted with the heap of rubbish in the box-room chiefly consisting of the remains of tin engines and other toys made in Germany. Of all the discreditable tomfooleries of which we have been the victims the "war on German trade" was the most idiotic.

I think an excess-*income* tax, chargeable on all *individuals* who had higher income than in 1913–14 would have been better than the excess profits tax chargeable on the business. It mightn't have brought in so much money as the same rate of excess profits tax, since an individual who had lost by diminution of dividends in one company could set his loss against excess from another, but this would have been largely compensated by the hitting of large numbers of people who get off altogether at present owing to their extra earnings not being

profits of businesses under the Act, and it might possibly have been applied even below the income-tax limit to some extent.

III

A LABOUR-SAVING SUGGESTION POLITELY RECEIVED

[(1) A letter to the Secretary to the Post Office with (2) the reply received five months later. Many new post offices have been built and many old ones refitted since 1916; will readers kindly notice whether the arrangement proposed has been adopted in any of them, and also whether there are still offices and sub-offices where the parcels have to be handed over a high wire fence?

The matter may seem a small one, but "mony a mickle makes a muckle," and it is typical of the callousness with regard to unnecessary labour which prevails, and that not only in Government establishments. It is noticeable that extra labour thrown on "the public" counts for nothing in the reply.]

[1. *The letter.*]

April 9, 1916.

SIR,—

In reading lately an article by a woman on her experiences as assistant in sub-post offices, I was struck by her remark that lifting parcels on to the weighing machine was tiring work. It occurred to me that I had never seen a post office in which the machine did not stand on the top of the counter so that all the parcels have to be lifted up the full height of the machine, I suppose about nine inches, to be placed on the scale: the weights, too, whenever they are changed, which I should think, allowing for errors in trial, must be for quite two-thirds of the weight of the parcels, have also to be lifted the same height. Here is a vast tonnage lifted unnecessarily, often at a height in the neighbourhood of the shoulders of the worker and therefore involving greater effort than if at a convenient level.

The loss of space incurred if the counter was cut so as to allow the machine to stand on a shelf underneath with the scales flush with the surface of the counter, so that both parcels and weights could be put on the scales with a minimum of effort, would be comparatively a trifling matter.

[2. *The reply.*]

G.P.O.
13 *September*, 1916.

SIR,—

With reference to your communication of the 9th of April last in which you were good enough to suggest that the parcel counters in Post Offices generally might be cut so as to admit of the scales being placed at a lower and more convenient level, I am directed by the Postmaster-General to state that the suggestion has been carefully considered.

The alteration of existing counters in the manner proposed would involve a considerable expenditure, which—in present financial circumstances—would hardly be warranted; and, apart from this, the public themselves place a large proportion of the packages direct upon the scales instead of on the counter top, and the labour of the staff is thus sensibly reduced.

In some cases where there has been reason to think that the handling of parcels by the counter staff was unduly arduous, low platforms have been placed on the floor behind the counter and the effort involved in lifting parcels has been correspondingly lessened.

I am to thank you for the trouble which you have been good enough to take in the matter, and to inform you that your suggestion will be borne in mind.

IV

INTERNATIONAL ANARCHY FROM THE ECONOMIC POINT OF VIEW

[In May and June, 1916, five public lectures on "World Relations and World Organization," arranged for by the Council for the Study of International Relations, were delivered at the London School of Economics. The following, entitled "The Economic Aspect," on May 23, was the third of the course, the others being "The Racial Aspect," by Mr. Arnold J. Toynbee; "The Political Aspect," by Mr. Delisle Burns; "Culture, Ethics and Religion," by Mr. F. S. Marvin; and "The Legal Aspect," by Professor A. F. Pollard.]

"THE Economic Aspect of World Relations and World Organization" may be taken to be, I suppose, world relations and

world organization as they strike the eye of the economist, taking the word economist not in any narrow sense as the academic professors, but as all fairly intelligent persons who are interested in the more material side of human nature.

It would be natural to begin by considering how the subject struck the eyes of the economic writers of the past. But here we are at once brought up by the discovery that those writers did not think of the subject at all. It seems that our introduction would resemble the famous chapter on snakes in Iceland. But it would, I doubt not, have been possible for anyone with the requisite knowledge to write a very useful chapter on the absence of snakes in Iceland, and on the same principle we may usefully inquire why the economic writers did not think of the subject and what the result of their neglect has been.

The mercantilists were frankly nationalist: their inquiry was started by purely practical national aims, and there is nothing to explain in their not arriving at a wider outlook before they were superseded. But what about the free-trade school which succeeded them? The free-trade economists were often accused of cosmopolitanism, because, ever since the time of Dudley North at least, they have claimed, in his words, "that the whole world as to Trade, is but as one Nation or People," but their cosmopolitanism rather took the form of ignoring the States among which the world is divided than of attempts to show what part the States, or even the countries which the States represented, played in the organization of the world, and how this part might be made a better, a more useful part. If they do allude to the conceivably better arrangements which might be made, it is in the slightest possible manner. Thus Jean Baptiste Say, not in his popular work the *Traité*, but in his larger *Cours* (T. II, pp. 279–80), says:

"Henry IV of France, the virtuous Abbé de St. Pierre, J. J. Rousseau, all proposed plans for perpetual peace, which have been regarded, rightly, as merely philanthropic dreams. For indeed what sort of a tribunal would it be which would decide the quarrels of peoples without having any means of executing its sentences? And if, in order to execute its sentences, it called in the armies of the powers, can we believe that the powers would lend their troops and bear the expense of a war except in the interest of their own policy? It would still be might rather than right which would win."

He had a good deal of hope in the future power of public opinion and in the probability of peoples coming to see that friendly relations paid better than hostile ones, and that is all. The only world-organization really present to the minds of the economists of this school was what they supposed to be the "natural" organization of production founded on individuals' pursuit of their self-interest, and they did not understand that the actual harmonious co-operation of the world was dependent on institutions the development of which requires the existence of law and government. They conceived it as independent of the States, which indeed were regarded as obstructing rather than promoting it. This view is, of course, connected with their want of appreciation of the economic function of the State within the boundaries of each country: with their great distrust of state action inside a country they were not likely to ask for what may be called a Super-State. They did indeed profess a great belief in the economic advantages of what they called "security"—the preservation of order—and did admit that this was provided within each country by the State of that country, but the security thought of was individual security, the security enjoyed by single persons from disturbance by other single persons or small bodies of persons, and did not include the security of the whole world from wars between entire peoples. So there was no acute realization of what seems to us the striking inconsistency of supposing that The State, i.e., each State, stands for security within its own territory, but that *internationally* the States exist chiefly if not entirely for the purpose of carrying on armed conflicts with one another.

The supposed cosmopolitanism of the free-trade economists thus really came to very little. They were generally content to discuss the good of "the nation" to which they belonged, rather than the good of that larger society which they occasionally conceived—and that, too, not merely for the sake of the weakness of the flesh of their readers, who would probably prefer the interests of their nation to that of the world at large, but because they themselves had neither the altruistic spirit which would make them prefer the interests of the whole to those of their own part, if the two interests conflicted, nor the scientific spirit which would induce them to discuss the matter merely in the pursuit of knowledge for its own sake.

Hence a slovenly confusion between the nation and society at large which, among many other bad effects, put national violence and the preparations requisite for its manifestations in a very peculiar place, as I will proceed to show.

There were before the present war developed, many, and there still are a few, persons who believe war to be either a good thing in itself or a thing which has a good effect on the world at large. But the great preponderance of opinion is against it, and that especially on economic grounds. The greatest admirers of war think of it as ennobling the mind, making people ready to incur sacrifices. We have all, or nearly all, been brought up to admire Abraham because he was willing to sacrifice his son, his only son, at the behest of the Being he worshipped. We cannot fail to admire the men who are ready to risk the sacrifice of their limbs, their lives, and even their eyesight in fighting for the cause espoused by the government of their country, and still more perhaps the fathers and mothers who, with a much greater appreciation of the risk, encourage them to do so, and there are a few persons who would be sorry to see war disappear because it would deprive us of the opportunity of making these great renunciations—I dare say there are some who grudge Abraham the ram caught in the thicket. But there is not even a small minority who think that war makes the world rich: there is nothing to be said for it from an economic point of view. Consequently the economists might have been expected to treat the business of waging war and preparing for it as misdirected effort and waste. But their habit of identifying "the nation" with society has prevented that. If we identify the nation with society, and attribute a certain amount of ill-will to the constituents of mankind outside this nation-society, military effort takes its place along with, or even above, ordinary useful industries. It protects the peaceful country from being overrun by outside marauders, and is consequently just as economically necessary and advantageous as the work of the police, who fight the internal enemies of society, or the work of the doctors, who fight diseases. No matter what country a book on Principles of Economics or Public Finance (a branch of economics) comes from, it calls military effort "Defence."

Such opposition to war as we find in the great economic writers seems not to be founded on its bad effects on the world in general

but on a belief that nations are not sufficiently cool-headed to fight only when it pays. We have, for example, the rather famous passage in which Adam Smith recommends the defraying of war expense out of taxes rather than loans: if this were done, he says (*Wealth of Nations*, II, 411):

"Wars would in general be more speedily concluded and less wantonly undertaken. The people, feeling during the continuance of the war, the complete burden of it, would soon grow weary of it, and Government, in order to humour them, would not be under the necessity of carrying it on longer than it was necessary to do so. The foresight of the heavy and unavoidable burdens of war would hinder the people from calling for it when there was no real or solid interest to fight for."

This has a distinct "stop-the-war" and "don't-go-to-war" tendency, but is in no sense a condemnation of war from a cosmopolitan point of view, and I think it is typical. Even in these latter days Mr. Angell's appeal has been based on the same lines in its suggestion that even successful war never pays the winner.

In civil life we do not expect burglary to be abolished or seriously diminished by demonstrations that the swag is never worth the time and trouble devoted to its acquisition. Convinced that burglary is a bad thing, taking all parties concerned into consideration, we do what we can to deprive the burglar of the swag when he gets any, and endeavour to deter him from a repetition of the offence by punishment.

It is clear that economics wants universalization in this matter. We require to be asked to look at it from the human standpoint—with an eye to the interest of mankind as a whole—as well as from the standpoint of each particular nation abstracted from the others. When we do so, we see easily enough that the economic ideal is not the best possible "Defence" for each nation, but an orderly Society in which the sections have no need of defence, because of the reign of law.

What should we think of a Liverpool professor of economics who contended that it was the duty of the Corporation of Liverpool to raise regiments to defend the interests of Liverpool against the construction of the Manchester Ship Canal, and of a Manchester professor who advocated the enlistment of Manchester regiments to defend the right of Manchester to have the Canal?

In any true conception of orderly society, separate States must take their places as local authorities subject to a certain outside control.

It does not follow that the establishment of a certain control over States means that they must be stopped from doing everything which is harmful to society at large. Local authorities in a well-ordered country are constantly allowed to do things which are harmful to their fellow-countrymen because the repression of the acts would be still more harmful, or would cost too much. So, though the French protectionist government will not allow local protective *octroi* duties within France because it conceives them to be harmful to France at large, and though general opinion would probably say the protective duties of existing countries are harmful to the world at large, it would not follow that it would be the duty of a world authority to suppress national protective duties—any more than it would be the duty of a British Empire supreme legislature to insist on the introduction of free-trade within the Empire. So, too, a world authority might properly tolerate restrictions on migration enforced by different countries, even if it were quite clear that they were immediately inimical to the interests of mankind at large. In both cases the permanent interests of mankind would be better served by yielding something to the prejudices of sections than by attempting to override them This is of course the merest commonplace in ordinary government. "You cannot regulate everything from the top." We want a clear conception of Society—economic society—at large, including the whole of mankind, except only such parts of it, if there are any, which are isolated entirely as regards commercial communication and migration.

But in the light of this better conception, national violence would certainly be treated in the same way that local authorities' violence would be treated at present—it would be regarded as a thing so obviously and admittedly inimical to the general good that there could be no question about the desirability of suppressing all its manifestations and doing away so far as possible with any opportunity for them.

Even if this ideal were utterly unlikely to be realized in practice, it ought still to be adopted as a hypothesis in the interests of science, because we want to know what are the best possible

arrangements even when we are determined not to make them. There is often a second best and a third best course, and in choosing between these we are helped by a knowledge of what is the best course of all.

But is it true that the ideal is merely a " philanthropic dream " as J. B. Say calls it ? Let us remember that we are dealing with the " Economic Aspect." There are, of course, other sides. At one time people insisted on fighting for their religion: who fights for their religion now ? Mohammedanism and Christianity are divided in the war: each of the three great divisions of Christianity is divided. Possibly people must fight because they do not like each other's language or each other's complexion. As to that, I adhere to the opinion I expressed a few years ago, that questions of race and language will not be decided on the battlefield.[1] They will be decided by the vitality of races and the convenience of languages. But whether it is inevitable that they should be disputed on the battlefield is not a question for the economist. As a mere individual I would venture to suggest that if nations want to settle these questions on the battlefield, they had better make some preliminary rearrangements of boundaries and do a good deal of weeding out even within their new limits, besides revising their alliances.

All that I will attempt to deal with here is the alleged forces of an economic character which obstruct the substitution of order for international anarchy, and the forces of an economic character which tend to compel mankind to make that substitution. Is it true that nations feel their economic self-interest so strongly that the conception of the general good as paramount can never be accepted completely enough to allow the success of institutions founded upon it ?

As to this I think a great deal of encouragement is given by the fact that the greatest supposed national interests which seem to stand in the way, though they look like economic interests, are really military interests which put on an economic character so long as there is a possibility of military conflict and lose it immediately that possibility is excluded.

[1] *Economic Outlook*, 1912, p. 35. Some critic scoffed at the proposition because he imagined it was a prediction falsified by the Balkan War in which Bulgaria, Greece and Serbia defeated Turkey. But what question of race or language did that war decide ?

The most important of these is population. It was a commonplace of the earlier economists that population is the wealth of kingdoms. Malthus himself was all in favour of population: what he opposed was ill-advised attempts to increase it which could not be successful—a high natality followed by a high mortality. J. S. Mill, with his preference for a reasonable amount of solitude, is exceptional. In general, increase of national population has always been taken to be a thing to rejoice over, in spite of the later economists' timidly expressed preference for a small rich people as against a big poor one. If we ask why, the answer is plain enough. If people living on a particular area think they may have to fight people living on another area, they very naturally and quite correctly believe it to be their interest that the population of their area should be large and that of the potential enemy small. Numbers of men, and apparently of women too, are necessary for victory if the war is once begun, and may even prevent its being begun by the other side. Victory is expected to bring economic advantage, and defeat almost certainly will bring economic disadvantage. Consequently there is perfect justification for the popular belief that a large national population is economically desirable even at the cost of some diminution in the economic welfare of the individuals of whom the nation is composed. Hence principally the demand for "new markets" which are expected to enable the old countries to maintain a larger population: and in part, the demand for new territory, if the territory maintains or can be made to maintain an addition to the numbers that can be put in the field.

Similarly, it is the possibility of war which makes people think they have an acute economic interest in the magnitude of the aggregate capital and income of their country. A large aggregate enables them to maintain and equip larger forces, and so works in the same way as a large population, and becomes economically desirable for the same reason. Hence the desire to grab territory containing valuable sources of riches, even if those riches are not in fact to be transferred to any existing members of the nation, but are to remain in the hands of their previous owners.

Self-sufficiency, too, as a national ideal is supported mainly by the possibility of war. People think that they must have, within their own borders, what is required for war, and even what is required for the maintenance of the civil population, or

if that is impossible, they must at any rate control the channels through which the imported articles come, so that they may be sure of getting them. Hence not only much of the opposition to imports which gives rise to ill-feeling, but also the demand for seaports and control of the estuaries, straits, and the ocean itself.

Take away the possibility of military action, and you find that while the belief in the reality of these economic interests does not altogether disappear, their disturbing force is extracted. The patriotic inhabitants of a State, or even a Dominion, which is part of a larger whole with a common flag, like to see their own area increase in population and aggregate riches, just as the inhabitants of a town or county do, because prosperity is very properly regarded as, *cæteris paribus*, evidence of praiseworthy conduct. But this does not lead to any serious desire to grab new territory because it happens to be populous and rich. In promoting an extension of area a great town may sometimes be slightly influenced by desire to maintain its place as the second or third most populous town in a kingdom, but it knows that this is childishness, and would not admit before a Parliamentary committee that it was influenced by any such thought. It may covet some adjoining district in which there happens to be much rateable property and not much expense, because the annexation will make a slight diminution of rates, not because the annexation is vitally necessary in order to make it strong enough to overcome some hated rival. Provinces and subordinate or federated States seem scarcely ever to think of wanting alterations of boundary at all. As for the ideal of self-sufficiency, no doubt this does persist strongly in many subordinate and federated areas which have certain traditions, but its manifestations are greatly weakened when it is no longer connected with security, and present no danger whatever to peace if only the supreme authority has the sense to allow the area complete freedom in the matter.

The fact is that the establishment of a world order, so far from being a "philanthropic dream," is what the common practical man calls in his peculiar dialect "a business proposition," only opposed by archaic sentiment.

And it *is a proposition to which there is now no tolerable alternative, if we are to have any regard at all for economic welfare.*

There is nothing so astonishing in the present situation as the thoughtless belief held by many people that after the war is once

over, the various countries will be able to rub along in the old way without any considerable inconvenience. Those who hold this view, if they know any history, are fond of referring to the period which followed 1815. They say, "Oh well, at any rate there won't be another war for a long time: there was a forty years' peace after 1815, so there will be time to recuperate. The debt will not be as big in proportion to our resources as the debt of 1816, and, perhaps," this is said with less confidence as the war continues, "it may be possible to reduce military and naval forces somewhat."

Now as to the burden of debt, it may perhaps be true that for the United Kingdom it may not be greater in proportion to resources at the end of the war than the debt of 1816: it all depends on how much longer the war lasts. But we must not think only of our own country. The position of the other countries after 1815, worse as it was in many respects, was immensely better than that of this country in regard to their national debts. Napoleon borrowed scarcely anything, and left behind him a debt-charge of only 2½ millions per annum, to which was added the interest on the 28-million indemnity exacted by the Allies. Prussia's debt-charge was between 1 and 1½ millions per annum. The position as a whole in Europe, as regards debt to bondholders, will be far less favourable to the national exchequers at the end of the present war than it was in 1815, and in addition we must remember that the charges for pensions will be immensely higher. The two charges together are certain in some countries at least to approach, if not to exceed, the whole revenue raised before the war.

I have not met with anyone sanguine enough to suppose that the various countries concerned can raise the revenue required without inconvenience to anyone by the method of "taxing the foreigner," that is, by taxing each other. Between them they will somehow have to bear the burden, or rather so much of it as they do not repudiate. But there are some respectable authorities who maintain that there will be no burden: it does not matter, they say, how much money has to be raised by taxation and paid to bondholders and pensioners—it is merely a transfer from one pocket to another.

As to this we may point out that a transfer from one pocket to another is not without importance when the pockets belong to

different persons. The ill-concealed hope of some is that rearrangements of taxation may secure that the money going into the pocket of the classes which have saved money during the war may be taken out of the pocket of the mass of the people, who have subscribed but trifling amounts to the war-loans. This is not likely to be realized to any very great extent. Specious pretences may indeed prevent the working-classes of some countries from using their political power to defeat the scheme, but the silent working of economic forces will always prevent any great difference between the condition of workers of equal efficiency in different areas. Attempts to collect more from the workers in one area than from those in another will, imperceptibly no doubt but none the less surely, cause a check to the growth of population in the first area which will result in property there having to take on at least a great part of the burden intended for labour. So it may be admitted that the new revenue required will come for the most part from the propertied classes to which the bondholders for the most part belong, and the classes from whose pockets the taxes come will be much the same as the classes into whose pockets the interest on debt will go. But this is far from entitling us to say that the whole thing is a harmless fiction: if it were so, no one would object to repudiation. There will have been, at any rate, a great transference of property. The newly created "fictitious" property will be a charge on the old property and will be owned by persons not in the proportions in which new property created by normal savings would have been owned in ordinary circumstances, but in proportion to accumulations, abnormal both in amount and distribution, made under the extraordinary conditions of inflated prices due to the war and the methods adopted for meeting or appearing to meet the expense. And if this transference were perfectly harmless, we should still have the evil of taxation. Whatever the property may be called, the taxation on which it must be based will not be fictitious. Taxes not only cost money to collect but cause all sorts of inconveniences, and the higher the rates at which they stand the worse they are in that respect. The necessity of raising hundreds of millions to pay the interest on the "fictitious" property which the war has created will stand an enormous obstacle in the way of raising revenue for other purposes.

What then of the hope of reducing expenditure on military and naval preparation?

"Only crush the enemy sufficiently, and we may then look forward to a long period of peace and low expenditure, as in 1815–54?" Well, France was sufficiently well crushed in 1815, and there was a long period of peace, but what was the end? Forty years after 1815 the two most important of the anti-Napoleonic Allies fought each other, one of them having France for an ally: after several duels in the next sixty years we are now having a much larger affair, in which there is a reshuffling so effectual that every country concerned is either allied with former enemies or fighting former allies.

Obviously if we are to go on in the old way, we cannot expect to keep free of wars. The moment we finish the present one we must begin preparing for the next. We must expect it to come well within the next forty years, and we may take it as extremely unlikely that we shall have either the same allies or the same enemies.

I say that this is not a tolerable or practical alternative. The lesson of the war is that preparations may be unlimited. It is not now a matter of putting a bow and arrows in the hands of each capable man, and not being able to do much more. It is not even a matter of providing the best possible rifle and perpetually replacing it by a better one as fast as better ones are discovered. That sort of thing was good enough for the nineteenth century. We know better: we know that there is scarcely an industry or a branch of knowledge which cannot be utilized—prostituted, I would rather call it—for fighting purposes. The ideal of the military State is no longer a nation which can fly to arms at short notice and for the rest of the time is engaged in the arts of peace satisfying peaceful desires, but a State in which the whole life of the people and even the propagation of new lives is made *at all times* subservient to the one great aim of defeating the enemy, or some possible enemy, if there happens to be none visible at the moment.[1] Fortunately no people will

[1] See for some account of this Utopian Hell, Mr. J. M. Keynes's review of Professor Jaffé's, *Die Militarisierung unseres Wirtschaftsleben* in the *Economic Journal* for September, 1915, pp. 449–50, already referred to above, p. 51.

long submit to have any such ideal imposed on them, and any government which attempts to impose it is doomed.

If anyone doubts this I ask him, Does he think it likely that the rich will consent to see the remainder of their surplus gradually but rapidly sucked away—in this country much more than a quarter of it is gone already—till they are reduced to such wages as will keep them in efficiency so long as they can work, and after that to a pauper's allowance? And if he says that the ideal requires a socialist state in which no one would be richer than his neighbour, I ask him, Is it credible that socialist countries would abandon all that hope of a general improvement in material welfare which has been the basis of socialist propaganda hitherto, agree to live on the barest necessaries of life, and devote all their surplus power to conflict with one another, each producing and bringing up just that number of children which may be ordered by the War and Food Ministries?

These are the alternatives: either the permanent establishment of order, or bare necessaries and warfare. It was not so, you say perhaps, in the past? No, but only because we did not then possess the more perfectly organized modern State which knows how to throw into a conflict the whole force of all the inhabitants of its territory.

V

WHAT IS WEALTH? FIGHTERS AND MUNITION-MAKERS?

[Part of a review of Hartley Withers' *International Finance*, 1916, in the *Statistical Journal* for May, 1916. Mr. Withers seems to have been inclined to follow Professor Jaffé. See the note on p. 76 opposite.]

THE chapters are all luminous and interesting: as a writer, Mr. Withers is himself throughout. But it is the last two, on "Nationalism and Finance," and "Remedies and Regulations," that best bring out his peculiar position as an economist, or, perhaps I should say, as a moralist who happens to be able to write about economics better than any but a few economists. He has no real feeling for economic goods. True he quotes from Cobbett *On Gold*: "National prosperity shows itself . . .

in the plentiful meal, the comfortable dwelling, the decent furniture and dress, the healthy and happy countenances, and the good morals of the labouring classes of the people," a proposition in which economic goods certainly take the first place. But immediately above this quotation he says himself, "At least the war is teaching us that the wealth of a nation is not a pile of commodities to be frittered away in vulgar ostentation and self-indulgence, but the number of its citizens who are able and ready to play the man as workers and fighters when a time of trial comes." According to this definition the Soudanese under the Mahdi must have been one of the wealthiest nations ever known: the highest wealth would be attained by the world when every man in each nation was readiest to fight and every woman readiest to make munitions—and possibly every baby readiest not to cry if it failed to get its mother's or other milk. This may be morals of a sort: it is certainly not economics. But Mr. Withers allows his morality to colour his economics when he expects the "regeneration" effected by the war to start this country—and presumably the other allied and enemy countries, which are generally understood to be undergoing even greater "regeneration" than ourselves—on an accelerated career of prosperity. The actual destruction of capital he regards as trifling: the cessation of the creation of capital leaves the world no poorer than before (no account being taken of increase of population, which requires something like 1 per cent. per annum increase of capital to keep things level): munition factories and the skill and habits of industry learnt in them will be utilized: national debt contracted within a country makes a nation no poorer, so that (this is not said explicitly) the United Kingdom and Germany will not be much affected by their debts, but our Allies who have borrowed from us (though their borrowing was as justifiable as that of a man borrowing to pay for an operation to save his life, p. 174) will be "inevitably in the same position as a spendthrift individual who has pledged his income for an advance and spent it on riotous living." Experience is not appealed to, though Cobbett's *Rural Rides* might have suggested some apposite reflexions, especially on the social effects of the creation of an enormous fictitious property in war-loans, mortgaged on the taxation of a country, after the period of inflation in which they were contracted has passed away. We are "to

show that we can still make and save capital faster than ever," although "it seems to be probable" that the war will end in a way which will make "other such wars quite possible when we have all recovered from the exhaustion and disgust produced by the present one," so that we shall all have to begin paying for the preparations necessary, on the scale suggested by the present war, for the new "regeneration" to be given us by the next.

VI

WAR AND POPULATION

[A review of Warren S. Thompson, *Population: A Study in Malthusianism*, 1915, in the *Economic Journal* for June, 1916. In the table the figures for French deaths in 1872 were misprinted in the Journal; the author failed to correct a misprint in the number of female deaths in the proof, and the printers or sub-editors then altered the total to make it agree with this wrong number. More recent inquiry seems to show that there really is some ground for what the review calls the "grotesque belief" that war somehow raises the proportion of males born. The increase, however, if real, is so small as to be practically negligible. See *Statistical Journal*, January, 1918, p. 15.]

"THE conditions which made possible the unprecedented expansion of the European peoples in the last fifty years are passing away. The agricultural development which came as a result of rapid transportation, the invention of labour-saving farm machinery, and the abundance of new and fertile lands cannot be duplicated. The system of transportation can be greatly improved, but no revolution such as came with the development of the steam engine seems likely to take place again. The efficiency of agricultural implements will probably be greatly increased, but they have already reached the limit of practicability for extensive farming, not because the implements might not be improved upon, but because the days of extensive farming are rapidly passing as the new countries become more thickly settled. Fertile land is no longer to be had for the asking in the United States, and will soon be taken up in the other places where Europeans can thrive."

I should like to suggest that the next bishop who proposes to recommend unreasoning multiplication as a universal rule of

human conduct should take this passage from Dr. Thompson's book as his text. The predictions which it contains may be premature, but they cannot be erroneous in any other sense. This little planet is getting filled up; if we go on increasing our numbers indefinitely we must eventually make it too full, in spite of that steady progress in material equipment and knowledge which tend to set the limits of desirable density farther on.

But Dr. Thompson wrote the most of his book before the war, and it must be admitted that the ultimate trend of things now seems to us for the moment of less importance than the exigencies of the next few decades. The increase of population in Europe is having one of Malthus' "positive checks" administered with very great sharpness.

Those who look only at military statistics are apt to depreciate unduly the effect of war as a positive check. They should examine the mortality not only of the armies but of the whole population. It is true that the effects of the war of 1870 are scarcely noticeable in the Prussian figures of annual deaths, but that was unfortunately, as it turns out, a cheap war for the victors. The numbers of French deaths tell a very different tale. These, including those of Alsace-Lorraine (population 1,570,000) down to 1868, but not afterwards, are given in the *Annuaire Statistique* as follows, in thousands:—

	Males.	Females.	Total.
1866 . . .	450	435	885
1867 . . .	441	426	867
1868 . . .	471	451	922
1869 . . .	443	421	864
1870 . . .	553	494	1,047
1871 . . .	692	579	1,271
1872 . . .	410	383	793
1873 . . .	434	411	845
1874 . . .	401	381	782
1875 . . .	434	411	845

The average for 1861 to 1868 was 442,000 males and 431,000 females, while the average for 1872 to 1879 was 424,000 males and 398,000 females. Taking the loss of Alsace-Lorraine into account, we can scarcely doubt that the war and the resulting civil troubles accelerated the deaths of about 400,000 males and more than half that number of females. These already seem trifling figures; our war is not finished, and the subsequent civil

dissensions have not yet begun. When all is over, the loss of male life, military and civil, is not likely to be less than if the whole existing male population of Spain had been exterminated, or, let us say, the whole male population of England and Wales in 1861.

It used to be said that such ravages of death were soon made up by an increased number of births—in spite of the obvious fact that it takes twenty years for a new-born baby to replace a man of twenty. But even if "soon" be extended to cover half a century, the doctrine does not seem likely to be true, at any rate under modern conditions. There is, of course, no ground whatever for the grotesque belief that war somehow causes an increase in the proportion of male births, and the opinion that it leads to an increase in the total of births is probably only founded on the natural "banking up" of births; if large numbers of men are separated from their wives for a considerable interval and then return simultaneously, there will obviously be a considerable rise in births beginning nine months after their return, but this is at most only compensation for the births which did not take place owing to their absence. There seems to be no reason to doubt that the killing of a certain proportion of vigorous males in the prime of life and a less proportion of the remainder of an existing population causes a permanent loss of people, in the sense that it causes the population to be less at every subsequent moment than it would have been at that moment in the absence of the calamity.

Is it probable that the set-back administered by the war will diminish what used to be called "the pressure of population"?

Land, indeed, will be slightly more plentiful in proportion to people, but the loss of other material equipment, counting both what has been destroyed and what has not been created owing to the diversion of labour from construction to destruction, will probably have been more than enough to compensate for this advantage; the advance in knowledge and in the possibilities of organization which has resulted from the general stirring up of the world may do much to improve the position, but only on condition that it is devoted to the arts of peace and not of war. This only throws us back on the old question—the question which makes all others unimportant—Will the nations settle down after the war into a single society with a common organization strong enough to prevent fighting between its different members, or not?

Here the thought suggested by a study of population like that of Dr. Thompson's seems to suggest that militarism, by which I understand the faith that war is inevitably prescribed for the human race, whether by a beneficent Deity or by a malevolent Devil or by neutral Nature, is confronted by insuperable difficulty. We have for the present already returned to the sentiment of the eighteenth century, when, as Joseph Townsend complained in 1786, "The cry is 'Population, population! Population at all events!'" Our daily wail is "Men and yet more men!" with the corollary, "and women too!" If wars are to recur, each nation must utilize the intervals of peace by increasing its population to the utmost. To what motives can it appeal?

Religion, we may be sure, will be found of very little use, however enthusiastic the bishops may be. The local coincidence of high natality and faithfulness to the Church does not prove that Christianity, whether Roman or Greek or Protestant, is powerful, but only that the conditions in so-called backward districts are more favourable at once to high natality and faithfulness to the Church than more "modern" conditions. Moreover, any special appeal which a State may make to Christianity to help in furnishing men for war is embarrassed by the fact that the founder of that religion expressly rejected an appeal to the sword. Mohammedanism, which has a much better record from the militarist's point of view so far as its teaching is concerned, has nevertheless in practice failed so egregiously to maintain a proper increase of warriors that its extension north-westward may be dismissed at once.

Patriotism, if it could be made into a kind of religion causing the subject to revere the Government and be ready to give up everything in unquestioning obedience to its behests, might be extremely useful. The State would ordain that babies were to be provided, settle who should produce them, and in due course they would be forthcoming in the greatest possible numbers. But the prestige of no Government is likely to be increased by the war, and it is highly probable that women will not in the future give the same unreasoning support to the martial spirit as they have done in the past. The mother whom I heard say, as she read the casualty list, "If this is all children are for, women will refuse to have them," is not alone in her sentiment. There will certainly be a number of shirkers and slackers far from negligible

in this matter of propagation. National opinion may cry for compulsion, but there are some things more difficult even than to make a horse drink. One suitably armed man may take an unwilling conscript to the barracks, but ten cannot secure that a conscript shall exist if his potential parents are unwilling. We shall never see a Minister of Propagations running Controlled Establishments.

It would seem, then, that compulsory military service has not, after all, dispensed States from the necessity of bargaining for their soldiers. Owing to the contemporaneous introduction of the limitation of families, it only has the effect of compelling the State to bargain with parents in general instead of with the particular men whom it desires to enlist. In this there is great hope for the world. It means that the population which is necessary for military purposes can only be obtained by giving people such a prospect of a happy life as is wholly incompatible with an ideal in which each country is to abandon everything except the work of fighting the others. Moreover, it creates the possibility that the various national authorities holding that atrocious ideal may eventually lose sight of their ultimate object, the crushing of their enemies, in their effort to secure one of the means, the welfare of their own people.

VII

A PLEA FOR LARGE POLITICAL UNITS

[This article was written for *War and Peace*, but was not accepted. I never agreed with those who held that the satisfaction of nationalism by the establishment of a larger number of independent nations, each with its own foreign policy, would of itself tend to peace. It will only do so in the end if the breaking up of the old large units is eventually followed by voluntary coalescence of the new units into still larger wholes. We must hope this will happen.]

Both believers in the possibility of permanent peace and those who say that war is inevitable and always must remain so are in the habit of overlooking one of the most important of historical tendencies. This is the growth of the average political area and the consequent reduction in the number of communities claiming "independence" in the sense of the right to make war at will.

The fact that in spite of two years of war we still persist in regarding peace as the normal condition is chiefly due to the gradual substitution of territorial governments, steadily becoming bigger and less numerous as time proceeds, for the old small tribal and city communities. We must not allow the great and striking events of which we have written records to obscure the importance of the innumerable minor events which together form a far greater change. It is true that the Roman Empire was big, and that it declined and fell, and that its area is now occupied by the whole or part of over a dozen independent States, but we must not forget that it covered but a small portion of the habitable land of the globe, while the rest was occupied for the most part by an immense number of fighting bodies. There are now no less than six empires each of which includes a larger area than that of the Roman Empire at its zenith. Together they occupy nearly three-quarters of the whole unfrozen land surface, and with five other States of smaller area they include about 95 per cent. of the whole population of the world. The remaining 5 per cent. maintain about forty independent States among them, but many of these are so situated that they can take no military or naval action without leave from a powerful neighbour.

Why should anyone assume that the process of consolidation will go no further? Was the formation of the German Empire the conclusion? Since the date of that event we have seen the separation of Sweden and Norway, with no very obvious result so far, and the creation of several independent States out of the European portion of Turkey, with results which can scarcely be regarded with complacency by the most sanguine of nationalists. But against these relapses we have to put not only a considerable tidying up in Africa and Asia, but also the consolidations which we can now see must be the inevitable result of the present war unless they are rendered unnecessary by something bigger. The small countries will be driven, however reluctantly, to entrust their defence more completely to one or other of their great neighbours, and these neighbours will no longer be ready to undertake the task in the light-hearted manner of the past without full control over the foreign relations and the military preparations of the protected State. Even countries as large and powerful as France and Italy cannot safely attempt to stand alone. Moreover, the scientific and technical characteristics of

modern warfare are making impossible the policy of rapidly changing one's friends: any useful co-operation in the military and naval sense means a communication of information and a utilization of special resources which cannot be entered upon with safety unless it is intended to be permanent. We may be sure that we have seen the last of "*ententes*" which leave both parties to a dispute in doubt whether a member of the *entente* will take the side of his *entente* or not, and that we have also finished with the type of alliance in which one member is allowed to go to war without even consulting another, and from which this other member may secede with every show of justice and right on his side if he can then say that the action of his ally was aggressive and not defensive. Alliances will mean what they ought to mean, namely, that the parties to an alliance will act as a single unit in all those external transactions which may lead to war.

That this further reduction in the number of "independent" units by itself would tend to a further reduction in the prevalence of war there can be little reason to doubt. The bigger the unit the less likely is it to be hurried into war by the passion of a moment or to be gradually led up to it by the calculated machinations of a particular class or interest. The experience of the past is all in favour of the big units: small units have constantly been disturbers of the peace except where they live in awe of great neighbours. But does the probable reduction of the number of units give us any hope of the final extinction of war and the consequent disappearance of preparations for war, or does it only suggest bigger wars and organization for war on a bigger scale than we have been accustomed to? It would be well, no doubt, to have a larger proportion of years of peace, provided they are not simply devoted to more complete preparation for the years of war, but if we are to give up every comfort, refinement and enjoyment in order that we may be sufficiently prepared for the next war, it really does not matter much whether war comes every twenty or every fifty years.

Put in another way, the question is, Will the reduction of the number of units soon end in a reduction to a single unit? We can see now that there is already little room for more than two or three such units. What is the process by which the two or three are to be reduced to one? I do not suppose much

difficulty will be felt about the reduction of three to two: the one of the three which felt itself the weakest or the most likely to be attacked by the other two in combination would in all probability join one of the others. And if the two remaining units were very unequal in power, the weaker would be inclined to abandon competition and enter the other alliance, which would then be the World Alliance and have no further need of what the national economists and public financiers of all nations have always hypocritically called "Defence." But if the two last units were approximately equal in power, what is the solution? Can it only come by complete conquest of the one alliance by the other?

I see little reason to suppose that the two alliances would not come to a peaceable settlement resulting in their amalgamation. As a whole they could not be much affected by the semi-tribal "national" prejudices which people ignorant of the elements of economics are perpetually trying to found upon economic interests, and which so-called philosophers try to make respectable: and it is these prejudices that cause wars, and support them when they have once broken out. The present war would never have occurred if the alliances between which it is now fought had been constructed even as late as the beginning of 1914, not only because of the different estimates of the strength on each side which would have been formed, but also because there would not have existed between two such entities the national hatreds which brought in one combatant after another. Nor could the struggle be kept up as it is, if it were generally spoken of as the war between the Central Powers and the Allied Countries. The mass of the people in each of the countries imagine themselves to be fighting their own particular national enemies: in hating theirs, the Germans are obliged to take each in turn, being unable to hate comprehensively the whole number at once.

The practical moral which I should draw is that every effort should be put forward to make permanent the great alliance in which half the world is at this moment included. It seems to me a mistake to concentrate, as many friends of peace are doing, upon the terms on which the present war may be brought to an end. Doubtless there is a great difference between the best and the worst settlements which are within the range of moderate

probability. But to suppose that any settlement can be arrived at which " will not contain the seeds of future national quarrels " is altogether too sanguine. Neither the most complete annihilation nor the most tender treatment of the defeated party will do much to prevent future quarrels, because those quarrels are not in the least likely to be between the same parties. I do not know whether anyone in 1815 supposed that the war then concluded would be fought over again between the same parties, but if anyone did, we can see now that he was very much wanting in foresight: the long peace after 1815 was broken by a quarrel in which defeated France stood by the side of her former principal enemy, who was fighting his former most powerful ally, and now they are all three on the same side. It is inconceivable to me how anyone over fifty years of age can venture to disregard the probability of new groupings of the Powers when he remembers the origin of the term Jingoism, and recalls the Penjdeh and the Fashoda affairs, Joseph Chamberlain's warning to France to " mind her manners," and the Dogger Bank incident.

No terms of peace providing merely a settlement between the two sides in the present war will have much effect on that probability. What is wanted is that we, that is, the people of the Allied Countries, should do what is suggested by the fact that the one method of preventing wars which has proved successful so far is the amalgamation of political units. The most important amalgamations are the United States, Germany, and last but not least, the British Empire. The first shows that no hegemony is necessary, the second that the old units may keep their kings and courts, and the third that not only internal autonomy but autonomy with regard to external commercial relationships, and the sharpest differences of race, language, and religion may exist within the same unit, which may include territories scattered all over the world. The one essential is that the amalgamation should be a single recognized permanent organization for making war and peace.

It is to the creation of such an organ, for as many countries as possible, that statesmen should turn their efforts, without being discouraged by the thought that when once all nations have come into the alliance, there will be no outside world for it to deal with. By that time its work will have been done, as the nations will have lost the habit of thinking of their separate

military interests as much as the individual has lost the habit of keeping watch for fear his neighbours will annex a portion of his back garden.

The probability is that this policy will eventually be forced upon the various governments, whether they like it or not, but there is great danger that at first it may be greatly obstructed by ill-advised attempts to secure fiscal as well as military union. The experience of the British Empire is conclusive in favour of allowing scattered areas each with a considerable sense of its own unity complete freedom of action in this sphere.

VIII

TRADE AND WAR. THE CAUSE OR THE CURE?

[A review of Henri Lambert, *International Morality and Exchange*, 1916 (translated from the *Journal des Économistes*), and J. A. Hobson, *The New Protectionism*, 1916, in the *Economic Journal* for September, 1916.]

THE thesis of M. Lambert, who describes himself as a manufacturer of Charleroi, is that "by the very nature and force of things economic co-operation of peoples is the fundamental principle of International Morality." He undertakes to establish "rationally and without having recourse to such arguments of fact as suggest themselves to the mind, that Humanity will henceforth find itself more and more confronted by this inflexible dilemma: liberty of international trade, or international conflicts of increasing gravity between the most advanced and powerful peoples." Readers will gather from this that M. Lambert has not been improved in translation, but I have had the advantage of reading him in the original, and there, as in the translation, he gives me the same impression as I get from a street preacher—an impression of familiar words and phrases. His advice to the world seems to be "Introduce universal free trade, and you will have no more wars," and he rejects with contumely all other methods of pacification. He evidently has not had any experience of the difficulty of teaching elementary economics, or this belief would not leave him an optimist. We shall have to wait a long time for the suppression of war if we are to wait till universal free-trade prevails. "Such arguments of fact as

suggest themselves to the mind," to use his translator's phrase, indicate that he is putting the cart before the horse. In fact, peoples have set up high tariffs because they disliked the foreigner, and have lowered them when they disliked him less, and abolished them when they decided that the foreigner was not a foreigner but one of themselves.

Mr. Hobson, of course, looks a little deeper. In his earlier chapters he sets himself the easy task of demolishing the New Protectionism, which after all is nothing but the old protectionism utilizing the ill-feeling created by the war and its unchivalrous incidents. He does this very effectively, though it is impossible to agree with him that the defence value of food duties is disproved by the fact that the protectionist belligerents have abandoned them during the war. Very curiously he seems to think the case against them is aggravated by their being "comparatively self-supporting in their food-supply." The object of food duties, considered as defensive measures, is to make a country independent of foreign supplies in time of war by enlarging normal home production: when the war actually comes, it is clearly unnecessary to pursue this object for the moment—in fact, to argue that the policy is a failure because it is suspended during war is like arguing that the Bisley shooting competition is of no use for the same reason. It would have been more effective to point out that experience seems to show that to secure their object in a long war hindrances to the importation of food will have to be supplemented by hindrances to the importation of the manures on which the more intensive cultivation is supported, and also that there are difficulties about putting your agricultural population in the battlefield, unless you are lucky enough to have succeeded in enslaving a large number of your enemies at an early period in the war.

More interesting is Mr. Hobson's last chapter, "The Open Door," in which he unfolds his positive contribution to the solution of the problem. Unlike the enthusiastic M. Lambert, he admits that simple protectionism "does not normally promote hostility" between countries. In his view the prime cause of modern wars is the struggle between the European powers for fields of exploitation in the "undeveloped" regions of the world. They are, he thinks, almost necessarily dragged into supporting the schemes of their subjects. "No League of Nations, no Hague

Conventions, or other machinery for settling international disputes, are likely to furnish any reasonable security for peace or for reduced armaments unless this problem of conflicting interests in the profitable exploitation of new markets and backward countries can be solved." We must therefore, he believes, resort more and more to international arrangements and international commissions for regulating this exploitation and securing the open door.

I doubt this diagnosis. The quarrels between the great States about these undeveloped regions do not seem to me to arise either from the real economic interests of a few enterprising individuals among their subjects or from the imagined economic interests of their peoples as aggregates, but from the military or naval interests which are, or are supposed to be, involved. The economic interpretation of hostile feelings is generally a fraud. The root of wars is now, as ever, almost always the desire of dominance over the foreigner in the ruling class and the fear of being dominated by the foreigner which the ruling class contrives to implant in the uninstructed mind of the populace, partly by assuring it that its economic interests are at stake, but much more largely by playing on traditional semi-tribal dislike of the foreigner. The end may come through a tremendous class struggle overpassing national boundaries, and blotting out these international dislikes, but it is perhaps more likely to come through the system of alliances which Mr. Hobson condemns as "the chief cause of past insecurity" (p. 114). The desire for dominance, which is strong on behalf of a single nation with a tribal tradition behind it, is weak on behalf of a great alliance of nations of various languages and colours: with it weakens the fear of being dominated, not only because that fear is no longer so strongly stimulated by the class which wishes to dominate, but because the populace is confused by its inability to distinguish between allies and enemies and because the danger of sudden attack is diminished.

IX

WHAT THE COMMITTEE ON PRICES MIGHT HAVE DONE: AND WHAT IT DID

[In the summer of 1916 the Board of Trade appointed a committee "to investigate the principal causes which have led to the increase of prices since the beginning of the War." Instead of waiting till the committee reported, I decided to take time by the forelock and suggest what it might with advantage do. Hence the letter to the Chairman, Mr. J. M. Robertson, printed as (1) below; but as (2) my criticism of the first report of the committee shows, this procedure does not appear to have been very effective.]

1.

[Letter to the Chairman of the Prices Committee.]

July 11, 1916.

DEAR SIR,—

An old pupil of mine who now occupies a respectable position in the Civil Service asked me on Sunday what possible good the Committee on Prices could do. He thought, no doubt rightly, that you would not be able to make any effective suggestion for bringing them down, and he could see no other use for you. But in this I think he was wrong. The explanation of a disagreeable phenomenon is often extremely useful even where the phenomenon cannot be removed by any action on the part of the persons to whom it is explained. Intelligent endurance is much less wearing than blind revolt. Contrast the attitude of passengers in a train held up by signals before and after they are informed of the cause, however discreditable to somebody or other the cause may actually be.

It seems to me that you might be of great use in several particular directions: (1) You might, partly by adducing evidence and partly by argument, do much to lay the absurd bogy of "conspiracy" which crops up in every age, and reached what may be hoped to be the limit when Mr. Crooks complained that "the tragedy of it is that the poor believe the high prices to be caused by the war." It is to be wished they all did, but it is to be feared that those who agree with him that it is not the

war, but a conspiracy of profiteers to raise profits, are much more numerous than he apparently thinks.

The "conspiracy" belief takes two main forms:—

(*a*) The simplest of its exponents imagine that the mere agreement of certain persons to sell at higher prices will send prices up without any reduction of the quantity sold. The only way to deal with this is to inquire why, if that is so, these persons wait till there is a war. Why not have done it long ago? The confusion of the present seems a bad time for agreements of the sort supposed, and evidence would probably show that there have been less than usual. Examples might be suggested showing the hopeless absurdity of imagining that, other things equal, prices can be raised without reducing quantity sold.

(*b*) Slightly more intelligent holders of the "conspiracy" belief recognize that to carry out their nefarious scheme the "profiteers" must reduce the quantity sold below what it would be in the absence of their agreement to raise prices, and so in all times of scarcity, from the dawn of history to the present moment, we get stories of speculators raising prices by (1) holding back supplies, and (2) actually destroying part of them. As to holding back "in hope of still higher prices," it only needs to be pointed out that when they do this the speculators are almost always justified in their hopes, and that whenever they are justified they have performed a useful service to the consumers by making them spread their consumption more equally over the whole time than they would have done if prices had not been raised in the earlier part of it. The very striking failure of the very "efficient" German Government to spread the consumption of potatoes and other articles over time anything like as well as ordinary "speculation" or trade would have done it might be made useful here. As to actual destruction of goods which would otherwise have come on the market, besides asking for actual evidence of such a thing, and of course failing to receive any, it would be useful to point out that it could never be the interest of one competitor among several to destroy his own stock or part of it in order to raise prices, that to combine a number of former competitors in such a scheme is a matter of great delicacy not likely to be attempted in a time of confusion and stress, and that the just conceivable circumstances in which the plan might pay an absolute monopolist are most unlikely ones.

(2) While not believing that shortage is entirely due to the action of wicked speculators or profiteers, there are many people who are seriously troubled and imagine "there must be something wrong" when they find that prices have risen in a larger proportion than that in which supplies have fallen. "The supply," they say, "has only fallen 5 per cent. and the price has risen 30 per cent. Does not that prove that something is wrong?" These people must be asked whether they really believe in the rule implied in their question. When the supply is curtailed, the price has got to go up enough to reduce people's purchases in the aggregate to the reduced amount of supply. Will a rise of price exactly proportionate to the reduction of supply be sufficient to do this? In regard to some commodities obviously it will be sufficient and more than sufficient: but in regard to the more "necessary" articles it will clearly not be sufficient. If anyone doubts, let him ask himself whether a doubling of the price of salt, bread, meat and boots would induce him to buy only half as much as before of each of those articles.

(3) Admitting fully that a shortage of supply justifies a rise of price, and even, in case of necessaries, a more than proportionate rise of price, many persons are greatly troubled because they believe that there is no shortage in the case of some article which has risen in price.

(*a*) Sometimes this belief is only founded on the observation that "anyone can get plenty of it, if he has the money to pay the exorbitant price asked." It is difficult to know how to deal with so silly an argument, unless by pointing out that anyone can always get plenty of diamonds if he has the money to pay the price asked for them. The fact that early strawberries can easily be bought at 2*s.* the pound does not prove that there would be enough to go round if the price asked were 6*d.*

(*b*) But sometimes the belief that there is no shortage is founded on observation or statistics which really prove that there is no less of the commodity supplied than before. This is doubtless the case of many of the commodities which have risen recently.

The trouble here arises from insufficient attention to the effect of changes in demand. Every one is willing to admit the influence

of "changes of fashion," which cause people remaining the same in numbers and wealth to alter their demand for different commodities, and they see that if war breaks out, munitions of war will be more demanded and likely to rise in price, but they do not appreciate properly the effects of the lavish expenditure of governments upon armies and munitions in altering the demand for commodities of ordinary consumption.

There can be little doubt that the general trend of this lavish expenditure, especially in this country, has been to increase (for the moment) the aggregate amount of money available for the purchase of the more important commodities largely consumed by the working-classes. The governments have charged themselves with the task of liberally feeding some millions of young men engaged in outdoor exercise in positions and in circumstances where very considerable waste occurs: our own Government has probably been among the most successful both in providing the food and in wasting it, though the numbers maintained are not so large as in some other cases. Here is a considerable increase of demand for certain important articles of food. There is nothing to suggest that it has been satisfied by abstracting something from the food of those left at home. Some pensioners have starved, and no doubt many people with fixed incomes and no war bonuses have suffered a certain diminution in quantity or quality of food, but taken all together the population seems to be, if anything, rather better fed than usual, the allowances to dependants and the high wages in many industries having increased the aggregate power of the working-classes to spend money. It seems paradoxical and in fact opposed to all sound economics to say that a war increases the purchasing power of the working-classes, who form the bulk of the community. The explanation lies in the fact that the phenomenon is a temporary one which will have to be paid for later, as it was after 1815. By stopping the creation of new houses, machinery, etc., and neglecting all but the most urgent repairs, it is naturally possible to have a good time for a few years, but it is only at the expense of subsequent years, in which a grinding depression follows the unhealthy boom.

(4) Practical suggestions for reducing prices are too frequently based on a cost-of-production theory which is no longer, if it ever was, held by economists. It is supposed that the price

of a commodity depends on its cost of production, and therefore that if some part of its cost of production can be reduced, by whatever means, the price will fall. So, for example, people suppose that high freights are causing the price of imported articles to be high, and that if shipowners could be compelled to accept less money for carrying the same quantity, prices would be lower. But the fact is that the price paid by the consumers is settled by the quantity offered them and by their demand. Provided that the quantity brought into the country remains what it is, the reduction or lowering of freights would make no difference except that some other party than the shipowners would then get the extra profit which they get now. The difficulty is not in the freights charged but in the small quantity carried—a quantity which a forcible reduction of freights will further diminish. Some one says, " You must of course go further, and see that no one gets the extra profit of which the shipowners are deprived : the merchants and shopkeepers must have their charges prescribed, so as to secure that the consumers will get the benefit." But this leads inevitably to the ration system, in which the government has to settle how much each person is to have, since it is certain that at a reduced price the same quantity of the commodity will not go round. Now to organize a ration system in time of peace is difficult enough : to try to do it in the middle of a great war is much more so, and quite sufficiently discredited by recent German experience. (It is particularly noticeable that though demanded in the interest of the poor, the German ration system was first applied in the form of equal rations of an article which the poor use in larger quantities than the rich.)

(5) The above remarks would all stand in the absence of any change particularly relating to the medium in which prices are reckoned. But of course a considerable part of the rise of prices which we have seen since the beginning of the war is due to a continuance of what was going on before the war—a growing pleantifulness of gold due to successful efforts to extract all the gold in the earth as quickly as possible without regard to future requirements. To this the war has added a great contraction in the demand for gold as currency owing to the issues of small paper. I used on the average to keep about £7 in gold in my pocket or in my wife's housekeeping drawer : now we keep a

slightly larger sum in currency notes, and the government holds about a quarter of their value in gold against them: thus our demand for gold in coin or bullion available for coinage is reduced to less than £2, while our demand for gold ornaments and false-teeth plates remains as before. The national banks of the belligerent countries profess to have increased their holdings of gold, but if there is on the whole any increase, it must be far less than the amount taken out of the circulation. The balance has been thrown into the neutral market along with the usual annual production from the mines, with the natural effect of diminishing the value of gold, *alias* raising prices, so that we are faced with a general rise of prices, and the particular rise of the "necessaries of life" due to the change in the direction of demand is on the top of this general rise.

(6) The only real cure for the high prices is to finish the war and substitute for it an orderly state of things. An orderly world will eventually regulate its currency in some way instead of allowing it to be at the mercy of every gold discovery and every invention in methods of extracting it. But the mere end of the war will cause a big enough drop to satisfy most people for the moment.

Till it ends, the best thing to try is more taxation and less borrowing. Reckless borrowing inflates: taxation deflates.

2.

[A review-article in the *Economic Journal* for December, 1916, on the *Interim Report of the Prices Committee on Meat, Milk and Bacon.* Cd. 8358.]

When Governments have failed to fulfil their primary function of preserving peace among the human race, and their subjects are involved in a sanguinary struggle, they cannot raise all the money they want by taxation, and they are afraid to raise even as much as they can by that method, because they know it would diminish warlike enthusiasm. So they borrow every penny they can at home and abroad on the security of the yield of future taxation and rake in as much as is possible by the issue of paper. Securing in this way an enormous amount of "money," they proceed to spend it in paying for warlike labour

and commodities at a far more rapid rate than individuals in normal circumstances would have spent it, whether in luxurious living or in new investments.

Of course, to some very considerable extent, the more rapid spending tends to increase activity; the unemployed diminish or disappear, old men are kept on or return to the work from which they have retired, boys are dragged away from reluctant school authorities, prejudices against the employment of women are swallowed by the most pronounced misogynists, and under the stimulus of overtime-wages a certain amount of extra work is done. The more rapid spending has, in fact, as more rapid spending always does, produced a boom. But, again as usual, the increased rapidity of production does not come up to the increased rapidity of spending—and where the borrowing is enormous, it does not come nearly up to it. The Governments think they must have the services and commodities at whatever cost, and to hurry up the supply they offer higher prices: it makes no difference whether they are buying in an ordinary market or whether they are bargaining with their subjects for the smooth working of a compulsory system—whether, for example, they are buying beef for their armies or paying allowances to the wives of conscripts. The inevitable effect is a rise in the prices of the commodities and services which the Governments demand and of those which are demanded by the private individuals whose money-means have been increased by the governmental demand.

This means a rise so widespread that to ordinary apprehension it appears universal. It is true that the non-governmental demand for new houses, new factories, new railways, and suchlike things in which the savings of society are commonly "invested" is diminished almost to nothing by the diversion of savings from ordinary investment into Government loans, but the materials ordinarily used for these things and the labour ordinarily used in putting the materials together are for the most part nearly what is required for making munitions, so that their price does not fall, but rises. The rise, in fact, spreads over almost the whole field of durable goods. All the same time, that great and important part of perishable goods which we inaccurately call the "necessaries of life" also rises in price. In part this is due to the direct demand of the Governments for food

and clothing for their armies: of course, the men in the armies were fed when they were civilians, but probably not on the whole so well, and certainly much less wastefully, than they are as soldiers. In part it is due to greater demand from the civilian remainder of the people. This arises from the fact that war requires so much simple "man-power"—physical strength coupled with courage and just so much mental ability as is necessary for the acquisition of rank-and-file skill—that the earnings of the lowest classes of labour are raised, both absolutely and in comparison with those of the higher classes. Moreover, army pay and allowances, being flat rates, also tend to increase the means of the poorest classes of the population compared with the rest. Now it is, of course, just these poorest classes who ordinarily have less of the "necessaries of life" than they would like to have. So, when they get more money, they try to buy more of these so-called necessaries, and add their increased demand to that of their Governments.

So it comes about that the war boom, like other booms, partly, at any rate, and usually, in the end, completely, defeats itself so far as the working-classes are concerned. They have got more money to spend, but in spending it they raise prices against themselves, and are not as much better off as they expected, or even are worse off than they were before, and that although they are working harder and some of them may be more efficient than before.

They are naturally disappointed: they complain that they are being exploited—that "profiteers" are "taking advantage of the war" to display a wickedness which is mysteriously kept in check in time of peace. Middle-class newspapers see "good copy." The great majority of the newspaper-reading public is always ready to listen to an accusation of scoundrelism against any small minority from whom it happens to buy some commodity: A to Y join cheerfully in slandering Z, without ever thinking that next week it will be Y's turn to be slandered by A to X, with Z, who has now forgiven his favourite newspaper's aberration in attacking his trade last week; and so on, with never a thought of the handle given to the hated socialist. Articles appear explaining that there is no shortage of this, that, and the other commodity and that the rise of price is due solely to the machinations of the "—— Ring."

Then throughout the belligerent countries, and even in neutral

countries if the war is a big one, poor, deluded souls cry to their Governments for redress. To their Governments! To the very persons and organizations which by their evil disposition have brought the war about, or by their incompetence have failed to prevent it by the provision of alliances of peaceful Powers against disturbers of the peace.

If the belligerent Governments were both well informed and candid they would answer the cry for reduction of prices somewhat in this fashion :—

"We are sorry you are suffering, but not at all surprised. It always has been so in war, and always will be. If you did not want war, you should have elected different persons to your Parliament (or rebelled against your sovereign or the bureaucracy which rules in his name). If you are prepared to stop the war on any terms which the other side would be likely to accept, you had better say so in large numbers instead of clamouring for the imprisonment of the few who do. The war being here, we are afraid you must submit to some reduction of your consumption. Can you seriously expect to get as much as you did in time of peace? We have taken away millions of able-bodied men from producing directly and indirectly the things which you eat and wear; in hundreds of ways we are obstructing the production of those things, so that not more, but less of them is being produced in the world at large, and especially in the belligerent countries. Whence are we to get more for you? If you think we can get more for you by compelling the rich to reduce their consumption, please remember that the rich are few and that their consumption of necessaries per head is very little greater, when it is greater at all, than that of artisans, so that no appreciable addition to the amount available for the mass of the people can be got from that quarter. If imports are free from interruption by the enemy we may be able to get a little by persuading neutrals to consume less, but we can only do so by offering enough to raise prices in the neutral countries so as to cause individuals there to buy less. The only comfort we can give you is that the high prices are encouraging the production of necessaries all the world over, so that probably some increase of production may be expected even before the war is over, if it lasts much longer, and when it is over there will certainly be a great fall in price."

But it is seldom Governments are both well informed and candid, and very often they are neither. Some of them are stupid enough to believe more or less in the popular outcry against the profiteers and imagine that it is not their own war, but a sudden special and unaccountable access of wickedness on the part of speculators and others which has caused the trouble. Others, more intelligent, only pretend to believe it: they know that their young men will readily sacrifice their lives and limbs and that their old men will readily sacrifice the lives and limbs of their sons and grandsons, and that their women will readily sacrifice the lives and limbs of their husbands, their sons, and their brothers in what they believe to be a noble cause, but they have a deadly fear—sometimes, but not always, well founded—that women and old men will shrink from pinching the stomachs of themselves and the young children, so that warlike enthusiasm will decay if it once gets about that the association of war with abundance to eat, drink, and wear is delusive, and that there is still truth in the old motto of "Peace and plenty."

So the general practice of Governments is to ignore the root-fact of the situation—the fact that when an overwhelming majority of the younger men of a large area are engaged in an attempt to kill each other, and some unknown but very large proportion of the rest of the people is employed in providing them with the tools for doing it, the mass of the population cannot long be maintained as satisfactorily as when nearly the whole of it is engaged in the arts of peace. Neither a century and a half of scientific economics nor about half as long of socialist propaganda has really convinced the populace and the newspapers of any country that wealth is dependent on labour. It is therefore possible for Governments to act as if nothing prevented people having as much as they want except the prices of the things wanted. Either, they say, people must be enabled to offer more money or prices must be "kept down."

Now giving people more money is quite an effectual way of meeting higher prices when it is applied to a limited class or a small area in commercial communication with the world outside; it enables the persons who get the increased money-means to increase their own consumption at the expense (production being for the time limited) of others, and so is a perfectly proper plan to adopt in favour of any class whose sufferings are likely in its

absence to be disproportionately great. But, applied all round, or anything near all round, it defeats itself by causing a further rise of price; even if applied widely only within the boundaries of a single country, it is exceedingly expensive to the State, involving heavy taxation, present or future, unless the State prefers bankruptcy.

Governments therefore fall back on the alternative of "keeping prices down." The more agile of the stupider among them promptly enact maximum prices. This ordinarily diminishes supply, and, whether it does so or not, it causes a worse distribution of what is available than took place before. Before, if you had some money you could buy some quantity, though perhaps not as much as you wanted: now, whether you can buy any at all or not depends on whether you get early enough into the queue or stand long enough when you have got in. The inconveniences and injustices of this cannot long be tolerated, so far as the more necessary articles are concerned, and some system of equal or graduated rationing is substituted for it in their case. And as these necessaries are not consumed much more largely in any case by the rich than by the mass of the people, the effect on the distribution is almost *nil*, but the Government is now burdened with an immense task in addition to carrying on the war. The more intelligent Governments know that maximum prices will not work, and fear the burden of the rationing system: others, unintelligent, are warned in time by the bad results of experiments made by their more active neighbours. So, instead of openly enacting maximum prices, they say they are "endeavouring to keep prices down by various indirect but more effectual methods." They will even venture to buy up large quantities of some important product, under the impression that the bargaining powers of public administrations are so excellent that they will be able to buy cheaper and sell cheaper than the wholesale merchants who ordinarily manage the business! When these and more reasonable methods fail, and prices go on rising, they try to gain time and push off responsibility by appointing Committees to inquire into the causes of the high prices and to suggest remedies for them.

Such is the origin of the Committee whose interim report is now before us; the appointing Government shows a slight leaning towards the light in the last words of the terms of reference,

which ask the Committee "to investigate the principal causes which have led to the increase of prices of commodities of general consumption since the beginning of the war, and to recommend such steps, if any, with a view to ameliorating the situation as appear practicable and expedient, having regard to the necessity of maintaining adequate supplies." It is something to have this admission that the lowering of prices must, after all, be subject to the maintenance of adequate (what is adequate ?) supplies, even though the main problem is still supposed to be the reduction of prices. The report is very much what might be expected from a Committee having this reference and consisting of the usual elements, with perhaps rather more than the usual very small percentage of members with an economic training.

It begins with an examination of the extent of the rise of prices in the United Kingdom, without noticing the fact that the United Kingdom is only a small locality in the much larger area in which the rise has taken place. This fact is, of course, perpetually cropping up as the report proceeds, but much greater clearness would have been obtained if it had been put in the forefront, and a distinction explicitly drawn between causes general to the whole area and causes peculiar to the United Kingdom. The Committee avoid committing themselves to any decision of the question whether rise of wages, conjoined with Army allowances and fuller employment and harder and longer work, has (or, to be exact, had, in September, 1916) increased the aggregate money-means of the working-classes of the United Kingdom to such an extent that they could buy as much as before in spite of the increase of prices, but they do say (I am not sure that it would be fair to write "they admit") that "the evidence taken goes to show that there is less total distress in the country than in an ordinary year of peace." It is only necessary that "any practicable method of checking the rise of prices should anxiously be considered," because "certain classes, normally in regular employment, whose earnings have not risen in the same proportion as the cost of living—for example, the cotton operatives and some classes of day-wage workers and labourers—are hard pressed by the rise in prices, and actually have to curtail their consumption, even though the pressure of high prices may have been mitigated in some cases by the employment of members of a family in munition works and by the opening of better-paid

occupations to women," and because " many people in receipt of small fixed incomes necessarily also feel the pressure; and it is obvious that while the total receipts of families past school age may have been greatly increased, a family of the same class in which children are within school age may suffer exceptionally." Having thus justified its own existence by saying that after the greatest war in history had been going on for two years " some classes " of the British population " actually had to curtail " their usual consumption, the Committee take in hand the particular cases of meat, milk, and bacon.

With regard to meat, the Committee begin with what seems to be a rather curious resort to what candidates for examinations in economics call the " cost-of-production theory of value," assuming that a rise in cost of production will affect prices immediately, instead of indirectly through its effect on supply or expected supply; at any rate, they seem to expect an immediate rise in meat prices to result from the increase in the cost of feeding and tending cattle in this country, without asking whether in fact the supply was being diminished. But this is of little importance, as they go on to say that the governing factor in the rise of price has been the demand of the Allied Governments for meat for their armies. " Not only do the new British armies in the field and in home training consume very much more per head than was the case in time of peace, but the French and Italian armies also make a new demand on the extra-European supply. Consequently, meat prices have risen in neutral countries in general as well as among the belligerents of the Entente." (In the Central Empires, they parenthetically observe, the rise has been much greater, presumably meaning to attribute it to the same cause—increased army demand.) The Governments having taken much more meat for their armies than the individuals composing the armies used to consume, there is naturally less left for the civilians, who raise the retail price by competing for this reduced quantity. The Committee say " it has been estimated " that civilians in the United Kingdom have " latterly " been cut down to five-sixths of their previous consumption of beef and mutton, but it is not clearly stated whether the previous consumption is the pre-war consumption or that of, say, March, 1916. It would be more satisfying, too, to know how the excision of the new Army from the civilian population has been allowed

for: mere counting of heads would be misleading, inasmuch as the men in the Army must have eaten more meat than the average (of men, women, and children, and even of adult men alone) when they were civilians. Rather confusedly, the Committee speak of the reduction as "a result, on the one hand, of the reduction of the imported supplies and attendant high prices, and, on the other hand, of the appeals made by the Government to the citizens in general to curtail their use of meat." The aggregate consumption was limited by the supply, and came up to that limit, so that Government exhortations cannot have kept it down: what they did, and were intended to do, was to induce some people to buy less than they could afford to buy, so that more of the limited total was left for others. Of course, in the long run voluntary abstention of the kind recommended would by its effect on price tend to reduce the total supply and consumption, but the Committee are dealing with a very short run, in which there was no time for any such effect. Voluntary abstention, in the circumstances supposed, is quite rightly treated as tending to moderate price, but should not be regarded as reducing aggregate consumption.

The rise in milk prices is attributed by the Committee partly to reduction of supply and partly to increase of demand. The supply has been reduced by the increased attractiveness of meat-production and also of cheese-production, and by shortage of labour. No attempt is made to estimate the amount of reduction which has taken place. The demand has been increased by the wants of the hospitals, the margarine-makers, and the tinned-milk and milk-chocolate manufacturers: nothing is said on the question whether the increased money-means of the working-classes has led to increased demand (measured by money offered) from the population in general.

As to bacon, the Committee do not even head a section "Causes of Advance," as they do with meat and milk. They spend some time in refuting a grotesque notion, which seems to have obtained some currency, that cold storage was the cause, and get to the end of the bacon part of the report without any definite statement of opinion about the real cause. But they seem somewhat annoyed with Londoners for not liking American bacon and being willing to pay more for other sorts; they say public demand is at present mainly for the best cuts, and it is difficult

to sell hocks and collars, even in poor districts, and they finish with the words: "There must have been a great increase in the military and other consumption to absorb the supply," which, so far as the United Kingdom is concerned, seems to have increased largely, so we may conclude that they attribute the rise of price to the increased money-means of the population. It would seem worth while to inquire whether the shortage (to the civilians) of beef and mutton may not have been a contributory cause.

To discuss, or even to summarize, the eighteen recommendations of the Committee is impossible in the space here available: they have been given in full by most of the newspapers, and the whole report may be bought for 2½*d.* The most interesting is, perhaps, No. 7. "In disposing of the meat which it purchases for the civil population, the Government should impose such conditions, not only on wholesale merchants, but also on retailers, as would tend to secure the sale of such meat to the ultimate purchasers at reasonable prices." The origin of this is to be looked for in paragraph 22 of the report relating to meat. From this it appears that Australian meat has been bought by the Government and resold, sale being entrusted to the firms who "formerly received the Australian supplies." These sell it on commission and are bound to do so "in the usual manner," so that "as far as possible it shall pass through the usual channels and in the usual quantities." "When supplies run short the distribution is *pro rata* . . . the distributors are held bound to sell only to *bona fide* retailers in the old proportions." This reminds us of the arrangement under which Parliament still distributes subsidies to local authorities in the proportions which it thought right in 1888. We have had two years of unparalleled movement, and the Government is apparently distributing Australian meat throughout the country as it was distributed before the quarrel between national States turned the world upside down. Truly a touching tribute from Government to the efficiency of private "profiteering" in providing for the wants of the people! It can think of nothing better than "the old proportions"! The Committee might have been expected to discover that the old proportions were probably wrong under the new conditions, which, among other things, include an enormous redistribution of population. But no, they only propose greater rigidity. They want the retailer to be bound down as to prices:

the inevitable consequence of which will be that his supply will often " run short " of the demand at the maximum price, and he will presumably have to see that his " distribution is *pro rata* " among his " old " customers. Housekeepers know that something of this kind is already said by tradesmen to be in force with regard to sugar, coal and coke, and wonder vaguely how a new-comer into a place gets served at all, not being an " old " customer of any of the dealers there. In the tenth century most of our ancestors were *adscripti glebæ*, bound to the land; in the twentieth we are becoming *adscripti tabernario*, bound to our shopkeeper. Truly, progress is only gradual!

1917

I

OPENING OF THE CAMPAIGN AGAINST INFLATION

[In August, 1917, Sir Hubert Llewellyn Smith, then Permanent Secretary to the Board of Trade, circulated for criticism a confidential memorandum on the probable course of prices on the conclusion of the War. No. 1 of the following papers was my response. After writing it I sent a slightly altered version of it to a high authority; and No. 2 is my reply to a part of his criticism. No. 3 was the result of a request from the management of *Common Sense*, a newspaper edited by my friend, Mr. F. W. Hirst.]

1. *A Letter to Sir H. Llewellyn Smith.*

[The inevitable collapse after the War is put earlier than it actually occurred, because at the time neither I nor anyone else imagined that war expenditure and inflation would continue for many months after the cessation of hostilities.]

BOURNEMOUTH,
August 19, 1917.

DEAR LLEWELLYN SMITH,—

I agree with the Memorandum on Prices after the War which you have sent me so far as it goes. I think however (1) I see some grounds for expecting a more precipitous drop in prices immediately the War ends, and (2) I should be inclined to add that present policy should be altered in such a way as to prevent prices being so high at the end of the War as they are likely to be if that policy is persisted in.

(1). Present high world-prices in gold have been caused partly by the belligerent States paying some of their expenses by means of issues of paper money which have taken the place of gold and thus helped the depreciation of that metal which was already proceeding in consequence of excessive issues of the metal itself from the mines. The striking rise in silver's gold price affords a

useful example of this depreciation. National money prices have been raised in various countries still higher, and to various levels, by the still further issues of paper, which has been driven down below its nominal value even when that value is measured in depreciated gold. On the conclusion of peace the more solvent countries will stop further issues and even begin to reduce existing issues: in the more insolvent countries the paper will lose all its value, and there will be a demand for gold to fill the void in the currency. This will have some effect in reducing prices, but not nearly as much as the stoppage of war expenditure. The belligerent States are all violently desirous of procuring the means of warfare quickly, and are ready to sacrifice almost anything in the future to gain this end. The effect is that of a very acute boom. In an ordinary peace boom prices are raised by the too sanguine estimate formed by enterprising people about the future prospects of their particular business, which makes them ready to pay high prices to get things at once: in a war boom, prices are raised by Governments' desire for victory and fear of defeat which make them ready to pay almost anything for immediate delivery of the goods and services they require. In both cases production is hustled up to a feverish pace which cannot be long maintained. Immediately peace is concluded, the expenditure of the various Governments will begin to shrink with enormous rapidity. In some cases it may stop altogether, owing to the dissolution of the State. In the others it will fall off by millions a week. Of many commodities the Governments will become incompetent sellers instead of reckless buyers. Profits everywhere will drop like a stone. Earnings of labour will be exceedingly bad in the aggregate, because employment will not be offered freely at the extravagant rates of wages now prevailing, and men and women will not readily take it at a large reduction. Moreover, large numbers of men who have been in the armies will be doubtful about what they want to do and where they want to go. Most people will be inclined to "Wait a little and see how things shape" before launching into reconstructions and extensions or even undertaking "necessary" repairs. The yield of taxation will drop so prodigiously that it will soon be obvious that few if any of the belligerents can possibly meet their engagements except by taxation which their subjects will not bear. Some measure of default is likely to take place on belligerents'

national debts except in a few countries which may be able to get over the difficulty by the kind of compulsory liquidation involved in a drastic levy upon all property to pay off the national mortgage and be done with it.

Towards the end of the Napoleonic war people in this country had the same absurd belief in a boom coming on the conclusion of peace that many authorities have now. There was a tremendous disillusionment then, and there will be again. Complete collapse of prices and general gloom and depression are sure to come, and will probably be diversified by civil strife.

(2). What is required to mitigate the fall of prices is to reduce the present inflation of prices or at any rate to check its further growth. The most effectual means of effecting this would be to spend less on the war, but dismissing that as impracticable, we still have two simple expedients which would improve the national position to some extent. One (*a*) is a reduction of the currency, or at any rate a stoppage of its further increase. The other (*b*) is to raise more of the money required for the war by taxation, and, which is much the same thing, by charging higher prices for goods and services of which the British Government has a monopoly.

(*a*) I am not a monetary expert and do not profess to be able to express a judgment on the monetary policy adopted at the outbreak of the war. But it does not require a monetary expert to judge of the policy at present pursued of paying a large and apparently increasing amount of the war expense by the issue of more and more practically inconvertible notes which are at a discount compared even with depreciated gold. I am aware that nominally Treasury notes are redeemable at the Bank of England, but I have not met with anyone who has had the temerity to try to exchange them there, and I have not the courage to try myself, and I know that the government has actually prosecuted persons for buying sovereigns at a price exceeding £1 in notes. If the Government were really ready to give a sovereign for a pound note, nobody would be so foolish as to give more than a pound note for a sovereign, and if anyone was, the Government certainly would not prosecute them. It cannot possibly be alleged now that the note issue is only just what is required to take the place of the more inconvenient metallic currency which was forced on the people of England and Wales alone among English-speaking

peoples for a century by stupid legislation. The issue has evidently exceeded that limit, and has gone to a discount, and if its increase is not stopped will go to a greater and greater discount. Before the war no fairly orthodox authority would have admitted that the British Government in any future war would ever endeavour to pay its way in inconvertible paper. The past was supposed to have shown the folly of the plan. That opinion was perfectly correct, but war seems to deprive people of their reasoning faculties.

(*b*) The inflating effect of borrowing rather than taxing is not so obvious as that of issuing excessive quantities of paper money, but it is equally certain, and at present in this country accounts for a larger share of the actual inflation.

When it is alternative to higher direct taxation hitting the rich, Government borrowing tends to inflate prices by causing people to form exaggerated estimates of the available income they are likely to have in the future. When the Government borrows £1,000 at 5 per cent. from X and taxes X and his heirs £50 per annum plus costs of collection in perpetuity in order to pay the interest, X is really a little more damaged than if he had been made to pay £1,000 down in direct taxation. But not one X in 10,000 realizes this. The ordinary X either shuts his eyes to the future taxation or expects somebody else to pay it. Till he finds out his mistake, he continues his expenditure at a higher rate than he would have done if £1,000 had been taken from him by taxation. This causes expenditure in the aggregate to be higher than it otherwise would be, and higher than is justified by the real circumstances. The higher Government expenditure is not counterbalanced at once by an equal decline of individual expenditure.

When the borrowing is alternative to taxation of commodities consumed by the mass of people it inflates the tax-free prices of articles of general consumption in particular. Borrowing only tends to diminish the demand for articles of general consumption to a most trifling extent. In spite of the absurd statistics of the War Savings Committee (in which I appear as "The Working Classes" because it happened to be convenient for me to take up my 500 of War Savings Certificates in two instalments rather than all at once), only a negligible portion of loans comes from any but the well-to-do. Probably not 1 per *mille* of the amount

raised by borrowing for the war represents reduction in consumption of bread, beef, and all the other things people have in mind when they deplore the rise of prices. On the other hand, to clap a tax upon an article of which nearly the whole is consumed by the mass of the population and which will not readily be abandoned in favour of substitutes tends strongly to diminish the price of other articles of general consumption, since it inevitably reduces the money demand for them by diminishing the spendable money-income of the purchasers.

As a first example we may take the case of sugar. When sugar became insufficient to meet the demand at the old price, the Government might have increased the tax (not by, as actually happened, an inadequate amount, but) by an amount sufficient to cut down the demand to equal the supply. The supply being entirely under Government control, would not have been diminished by the reduction of consumers' demand; we should have got just as much sugar as we have had, but the people would have had to pay more for it directly than they have had to pay under the policy of fixed prices, and would have had less to spend upon other provisions, which, accordingly, would not have risen so much as they have done.

As a second and converse example we may take railway travelling. Here, being unable to satisfy the demand at existing prices, the Government took the course of clapping 50 per cent. increase or tax (it matters not which we call it) on to the fares. The demand promptly fell off sufficiently, and the remaining spendable money-income of the large numbers who still travel was reduced, with the effect of curtailing their power of raising the prices of other commodities and services. Many of the London munition girls on holiday who crowd the beach here can still afford the tobacco which a paternal Government is trying to cheapen for them, but the extra money paid for the trip must have cut down their purchases of something.

I submit that the policy adopted for sugar is wrong, and that adopted for railway travelling is right.

The one economic objection raised against reducing demand to the dimensions of a reduced supply by raising the price of the commodity demanded in a situation like the present is that "the poor will be unable to purchase." It bulks most largely in the minds of those who suppose that the rich in the aggregate

consume a very large amount of the necessaries of life above what they would get if the rule of equal rations for all prevailed. This large amount, it is believed, would be little reduced by a rise of price, inasmuch as the rich would go on buying nearly the same amount whatever the price. The poor would be "starved," or at any rate obtain amounts reduced much more than in proportion to the reduction in the total supply. In fact, however, the rich are so few in number, and their individual consumption of necessaries of life so little in excess of that of the average person that their existence is practically negligible. The population actually consists of an overwhelming proportion of persons whose consumption of "necessaries" is closely dependent on variations in their money-incomes and the prices of the commodities: it is only a trivial percentage of the population whose consumption of such things as sugar and beef will remain nearly the same though their incomes fall and prices rise, and the consumption per head among these people is not very much greater than among the mass of the people. (In bread it is actually less.) Hence a rise of prices does not in practice have the effect of entirely cutting off a section of the people from the commodity, or even of reducing their shares by a proportion exceeding in any appreciable degree the shortage of the total supply. What happens is a slight reduction nearly all round and mostly in the quarters in which it can be made with least suffering: part of it will be in reduction of simple waste, and part in abstention of those who can most easily dispense with the article. The fact should never be lost sight of that people are accustomed to order their economy by the guidance of prices and will not readily drop into any new scheme of arrangement. There will generally be more waste in 75 lb. given out in rations than in 100 lb. sold over the counter. It would require an extremely hardy controversialist to maintain that the distribution of sugar which has actually prevailed since the beginning of the war (or even that which is likely to prevail after October 1) is more admirable than that which would have prevailed if demand had been brought down to supply by an adequate increase of price (which would of course have been netted by the Exchequer).

On the economics of the question there can be no doubt, but it is said that political necessity dictated the adoption of the maximum price policy instead of the taxing policy. The working-

classes, it is said, would not stand the right policy, so the wrong one had to be adopted. I believe this to be quite unfounded. The objection of the working-classes to the war prices has always been based on the belief, fostered by most of the newspapers, that the rise was due only to the machinations of profiteers, who are supposed in some mysterious way to become either more wicked or more powerful in time of war. Complaint would not have been great against a rise of price which went straight into the Exchequer to aid in carrying on the war. This is not a matter of conjecture only, but is borne out by the quietness with which the rise of railway fares has been accepted. Though the financial arrangements between the companies and the Exchequer cannot be present to the minds of the general public, it was impossible for even the stupidest of newspaper writers to ascribe the increase to the operations of profiteers, and so it has been taken quite contentedly, though railway travelling is of more interest to the people at large at present than it has ever been before, and a rise of 50 per cent. at one jump is enormous. (Of course, it is on the top of the previous withdrawal of "cheap" tickets.)

My impression is that here, as elsewhere, in the end honesty will be seen to have been the best policy. By acting as if they adopted the view that high prices were due not to the war but to profiteering, the German Government and, following it as usual, the British Government, have given their adhesion to the doctrine that the war can be carried on without any economic sacrifice being demanded from the working-class. Life and limb indeed might be required from that class, but the whole economic loss could and should be borne entirely by the rich. The working-class has not been slow to note the admission of this doctrine by the Governments, and in the years of bitter social strife to come bourgeois politicians are likely to learn to regret that they were weak enough to countenance so gigantic an imposture as the policy which was based on the pretence that mankind could give up peaceful production and take to destruction on the scale of the present war without widespread economic suffering.

2. *A Letter to a high authority.*

[The passage about prosecutions near the end of the first paragraph is due to my correspondent having denied the statement that persons had been prosecuted for giving more than a £1 note for a sovereign (in No. 1 above, p. 109). To discredit the currency was an offence under the Defence of the Realm Act (known familiarly as DORA). The legislation compelling the use of gold currency was the prohibition of bank-notes for sums under £5.]

DEAR —— *October* 20, 1917.

. . . .

I never, as you say I did, "insinuated" that the notes were inconvertible; I said point-blank that they were "practically inconvertible," and I don't believe that you or anyone else denies that. You say I can go to the Bank of England (which will cost me 2*d*. from Clare Market in term-time and 16*s*. from Oxford in vacation), and ask for and receive as many sovereigns as I care to present notes for. I gather from a man who tried the experiment that I should be required to write my name on the back of one, possibly all—he only had one—of them (I dare say this is immemorial practice) and also be asked what I wanted them for (a disagreeable impertinence to which I should not care to subject myself). But you are careful to add that having got the sovereigns, I am not to be allowed to export them and shall be put in prison if I melt them down for jewellery or teeth. If that isn't "practical inconvertibility," I should like very much to know what is. It's like offering me a knife on condition that nobody in the country may cut anything with it or export it. For what possible purpose could anyone ever want to convert, except either to use the gold within the country or to export it? My friend when asked what he wanted the sovereign for, could only look foolish and say, "Oh! Nothing." What does it matter whether a man is prosecuted for defaming the currency (as surely he might be if he said twenty one-pound notes were only worth nineteen sovereigns) when he gives £20 in notes for 19 sovereigns or for "trafficking in them for the purpose of melting them down"? Given observance of the law, the technical, though hampered, convertibility is reduced to a mere sham, as the sovereign is necessarily decried to the level of the

one-pound note, whatever that level may be (as Ricardo observed in answering the objection that you couldn't get more than a one-pound note and a shilling for a gold guinea in 1809 or 1810). There is no point in the conversion of a paper £1 into a gold £1 unless you may treat the gold as gold and not merely as a heavy and inconvenient representative of the paper £1.

The parts of your letter which interest me most and also really alarm me are those in which you speak of "the myth that the Treasury, when hard up, have some secret device for *forcing* notes out into circulation," and seem to claim that the Treasury does not control the issue, but that it increases automatically in response to the requirements of the public. Isn't this what has always been said by the issuers of all paper currencies down to the very worst and most excessive? I can't imagine why anyone should suspect the Treasury of having some "*secret* device for forcing notes out into circulation." No Government was ever in a better position for introducing legal-tender and practically-inconvertible notes into the currency by the simple method of paying them away for goods and services received. The spending departments must pay out many millions of £1 and 10*s*. notes weekly, and so far as I can see there is nothing but the discretion of the Treasury and the Chancellor of the Exchequer to prevent the whole sum being paid by additions to the total of notes outstanding. As you say, "anyone who has a balance at the Bank of England can turn it into currency notes *ad lib*." The Exchequer has a balance at the Bank of England and can turn it into currency notes, but has the advantage over anyone else that its balances will not be depleted by its taking out the notes if its demand for notes is promptly met by the issue of additional notes. It can thus pay out the notes just as easily and with as little "forcing" as if it sent the notes direct from the printers to the wage-earners. It's only a very slightly roundabout way of doing the same thing. I suppose you will say that the Exchequer doesn't do this. I don't suppose myself that it does, but every other method is merely a slightly more or less complicated method of doing the same thing.

No one supposed that the gold-mine owners, whose pounds sterling cost them I am told somewhere about 14*s*. to produce, had any need of secret or other devices for "forcing" them into circulation, and I cannot conceive why a Government whose

paper pounds cost it perhaps a halfpenny should be supposed to require any such devices. The Government has only got to pay them away for goods and services: they will not return to be cashed in gold, however many are issued, because the Government will not give gold for them but only stamped pieces of gold which the holder may not do anything with except what he can do with the notes, and which therefore might just as well be made of heavy paper. Whether the Government pays a million of new (additional) notes direct to munition workers in wages or issues them to a bank or a system of banks in exchange for old notes can make no difference in the long run.

3. *A Newspaper Interview.*

[This appeared in *Common Sense* for December 29, 1917. The reference to the opinion of the Select Committee on National Expenditure is to the Second Report of that body, No. 167 of 1917, § 20.]

"Inflation? Well, if you had come provided with a definition of inflation which I found intelligible, I would answer your question. But, as every one gives his own definition of the term, and most of the definitions are unintelligible, I prefer not to answer. Is not all you want to know simply to what causes do I attribute the rise of prices which has taken place since July, 1914? I attribute it to the war."

In these words Professor Edwin Cannan started an illuminating conversation on a subject that is rapidly becoming a vital concern to every household, and, indeed, every individual. "But surely," I remarked, "that explanation is obvious." "Obvious?" he replied. "I doubt if it is to some people. I seem to recollect Mr. Will Crooks saying that it was a tragedy that the poor believed the rise to be due to the war. He apparently ascribed it to some sudden accession of wickedness in the minds of profiteers, as unaccountable as influenza usually is. If you want to know how the war has raised prices, I say this: Prices are higher when the things priced are less plentiful and when people have more money—or even when they only think they will have more money—to spend. Both these things have been brought about by the war. The armies themselves have withdrawn tens of millions of men from the production of ordinary commodities and services. These men are not a very large percentage of the total

population of the world, but they are a very large proportion of the working force of the world, as they consist chiefly of strong men in the prime of life. Add to them the further millions of men and women, and boys and girls, taken away from ordinary production and set to work in making warlike instruments, and you can see how ridiculous it would be to suppose that the world's production of ordinary commodities could be kept up to its usual amount. The additional labour brought in by the employment of women and children and old men formerly idle is a mere drop in the bucket, and is probably about balanced by the evil activity of the enormous and ever-growing Government offices set up to control this, that, and the other—usually to prevent people from doing something which it is perfectly desirable that they should do. In addition to the failure of production, there is the very considerable destruction directly effected by military and naval operations, and the enormous waste involved in feeding large armies in out-of-the-way and awkward situations.

"These things and many other results of the war," Professor Cannan continued, "cause the amount of ordinary commodities reaching the consumers to be less than usual. If they had, and knew that they had, only the same money-means as before, this alone would cause a rise in prices as a whole, and the rise would be especially marked in the more necessary articles, since people can do with less luxuries more easily than with less necessaries, and would consequently divert some of their expenditure from luxuries to necessaries. This has long been recognized. It is more than 200 years since Gregory King made his well-known estimate that, if the wheat harvest were deficient by one-tenth, the price of wheat would rise three-tenths, and, if it were deficient by one-half, the price would be five and a half times the ordinary price."

"What means, then, would you suggest for remedying, or at any rate checking, the conditions you have just described?"

"The shortage of ordinary commodities and services could conceivably have been met by a corresponding shortage of money to buy them with. If a large portion of the note issues of the world had been suddenly discredited, or if the gold mines had all been shut down—as they ought to have been—on the outbreak of the war, that would have tended to keep prices down. But nothing of this sort happened. The gold mines were allowed to

go on working much as usual, and the various Governments bolstered up every institution which seemed likely to fall into bankruptcy. Then they launched out into war expenditure without any clear perception that the magnitude of the production of military and civil commodities and services is limited by the amount of materials and labour available, and not by the amount of money which can be offered for them. If, by taxation or other means, they had caused their subjects' net incomes to fall off *pari passu* with their own increase of expenditure, all that would have happened would have been a large transfer of spending power from their own subjects individually to the Governments, and no effect would have been produced on prices. The aggregate spent would have been stationary. But this could not be done all at once, and, in fact, was not done later when it could have been done. Instead, the Governments ordered things 'on tick' regardless of expense, and when the bills came in they paid them for the most part not with sums of money obtained in ways which meant corresponding reductions of the money spent by their subjects individually, but with money obtained or created in such a way as to lead to no such reduction, or, at any rate, to insufficient reduction."

In reply to my suggestion that he should illustrate his criticisms by a concrete example of the operation of the method to which he was objecting, Professor Cannan said: "Let us assume that, during peace, the total money income of this country was 2,400 millions, of which 400 were saved (i.e., invested in additional machinery, houses, etc.) and the rest spent in everyday consumption. If," he continued, "on or soon after the outbreak of war, the State had simply taken 1,400 millions of this and spent it on the war, and the subjects had only the remaining 1,000 millions to spend and invest for themselves, the change would have caused a disturbance of prices, but no general rise. But as, without considering the fundamental facts of the situation, it proceeded to spend on the war at the rate of 2,000 millions a year, and left open the question who is eventually to pay by referring vaguely to 'posterity' or 'the taxpayers of the future,' it could not fail to raise prices enormously, against itself as well as against everybody else. Its purchases of commodities and labour at extravagant rates meant an increase in the money incomes of the persons whose commodities or labour are bought. These people, having

more money to spend, buy or try to buy more commodities and services for themselves, and thus raise the price even of those things for which there is no Government demand."

"But how can the Government have got 2,000 millions to spend if the total income of the country before the war was not more than 2,400? Surely it cannot have turned to its own purposes five-sixths of the productive power of the nation?"

"No, nothing like five-sixths. The explanation is that a million now represents far less, even when expended by individuals, than it did then, and that a million expended by the lavish hands of scratch Government departments means immensely less productive effort than a million spent by individuals now. We see the great figures of money spent on the war, and ejaculate 'Prodigious!' without reflecting that there is no limit to the *money* which a State can spend provided that those who receive it will hand it back again in taxes or in loans. It would be easy to double the laundry charges in the fabled island where the inhabitants lived by taking in each other's washing! Similarly there is nothing to prevent our Government paying us all a war bonus of £100 a day if only the War Savings Committee can persuade us to invest it all in National War Bonds—nothing, that is, except the slight inconvenience that the State will have to collect interest on the amount from the taxpayers until—if ever—it collects the principal, and who thinks of that? The debt is already equal to about half of the pre-war property of the nation: it may easily go to double or treble without the public worrying over it: each person thinks somebody else will have to pay the necessary taxes."

"Have not Treasury notes something to do with money buying less?"

"I don't think them a primary cause, since the issue of paper here, as elsewhere, has been due to the reckless Government expenditure. But no doubt a great part of the expense simply could not have been incurred if the various Governments had not watered their currencies. No sane person can suppose that the Russian State could have spent half as many roubles without the aid of the printing press. The Select Committee on National Expenditure seems to have been persuaded that there is some mysterious difference between the Government paying for goods and labour with notes direct from the press and paying for them

with notes which have been obtained from the banks in exchange for the newly-issued notes. This, of course, is nonsense, but such a small part of our whole expense—an average of rather less than a million a week for the last two years—is paid by the press, that we cannot suppose the Treasury increases the issue merely for the sake of the direct gain involved in the manufacture of 'pounds sterling.' The currency is watered and prices raised not for the sake of the million a week—what is that in these days? —but in order to maintain the credit conditions which make possible the continuance of the immense flow of borrowed money into the Exchequer. Without that flow the expenditure, measured in money (and in future taxation), would have to come down, though the quantity of materials and labour applied to the war might remain the same or even increase. Thus the continual enlargement of the note issue seems essential to the ruinous policy which is being followed. It increases the expenditure by far more than the million a week; in fact, you may regard it as constituting the grease on the financial slide down which our State is following all the enemy States and some of the Allies towards perdition."

II

THE INFLUENCE OF THE WAR ON COMMERCIAL POLICY

[A paper read on September 22, 1917, at a national conference of working-class associations, arranged by Ruskin College, and held at Birmingham. A complete report of the proceedings was published by Ruskin College under the title of *Some Economic Aspects of International Relations*, price *7d.*]

As time goes on, commercial policy becomes more and more controlled by considerations of employment, the dominating idea being the increasing of employment or at least the prevention of its decrease. Unfortunately, it is usual to regard every diminution of employment in any trade as an evil, and we cannot usefully approach the subject of commercial policy without some preliminary examination of this opinion.

When we work directly for ourselves we welcome with joy methods and appliances which reduce the labour of obtaining

any particular article, even if we want little or no more of the article than we have been getting. Just now, we all garden for ourselves, and know how nice it is to get a more effective tool or to learn of some method which saves labour in digging or hoeing. We do not regret the lost labour. Nor do we make reservations in favour of skilled labour: we cheerfully scrap our laboriously acquired talents if they are rendered unnecessary by the discovery of new methods or implements. The situation is obviously the same whenever a number of people co-operate consciously. There is no reason to suppose that a purely communistic society would have the slightest objection to adopting labour-saving methods or appliances: the labour saved would be regarded as a pure gain, since, if little or no more of the article produced by it is required, it can be applied in other directions, with the result of an increased total of desirable results, or it could be simply abandoned in favour of greater leisure.

But when we co-operate unconsciously by way of selling our own products and buying those of other people with the proceeds, changes in the direction of labour-saving generally have an unpleasant side. It may happen, of course, that the demand for the article is so elastic that when its production is made twice as easy and the price falls to one-half of what it was, a double quantity will be sold. In that case, no inconvenience will be felt: there will be no reduction of employment in producing the article. People are apt to think that this should always be so, but in fact, of course, the demand for most things is not and cannot be so elastic. It is much more usual for the demand to be such that an increase of production proportionate to the reduction of labour will cause such a fall of price that there will be less available for the remuneration of the labour, so that if all the previous workers insist on continuing, their position will be worsened; the same number can only be employed if they submit to reduced earnings—otherwise some must be excluded, which of course involves hardship, or at the very least inconvenience, varying in degree chiefly with the suddenness of the change. There is, of course, nothing exceptional or anomalous in this. In the case of an individual producing things for himself, a transfer of labour from one kind of production to another can be effected without inconvenience or

hardship by the exercise of the sovereign power wielded by his brain. In the case of a communistic society transfers of labour from one occupation to another would be effected similarly without hardship to the persons concerned by simple decree of the labour ministry or whatever department of Government was entrusted with the distribution of individuals between employments. But in society as we have it, people are attracted into employments and deterred from joining them, kept in them and driven out of them, by the different and changing comparative advantages which they offer as means of earning a living.

Recognition of this hardship is of course the most substantial cause of the sympathy which is widely felt with those who resist labour-saving methods and appliances. But the whole of the dislike for reductions of particular kinds of employment which prevails cannot be thus accounted for. Much of it comes simply from a fundamental misconception which leads people to suppose that labour itself is wanted instead of merely the things which labour produces, and which are not wanted because labour produces them, but are produced by labour because they are wanted. The habit of talking of each particular industry as "supporting" or "maintaining" those who follow it leads people insensibly into the belief that the industry directly supports or maintains those who follow it in such wise that a diminution in its amount would diminish the whole society's means of maintaining its numbers. If we say that bootmaking supports bootmakers, we are apt to fall into thinking that if we grew boots with as little trouble as finger-nails and with no more nourishment than at present, society, to be as well off as it is, would have to be less numerous by the whole number of persons employed in bootmaking. With some muddle of this kind in our minds we become inclined to regard every "expansion of industry" (in the sense of more labour being devoted to any particular kind of production) as a good, and every contraction as an evil. We are prone to rejoice indiscriminately over every increase of numbers employed in any trade, and to mourn indiscriminately over every decrease. We even sometimes go further, and rejoice not only over an absolute increase of numbers but over an increasing percentage of the whole number being employed in a trade, while at the same time, in defiance of elementary

arithmetic, we mourn over a decreasing percentage employed in another trade! The stock example is agriculture. Throughout history increasing knowledge and civilization have enabled mankind to get the raw materials supplied by the surface of the earth for human food and clothing with greater and greater ease, so that a larger proportion of human labour time has been gradually made available for working up that raw material into more refined forms. Labour being divided, the diminution in the proportion of the labour time required for providing the coarsest necessaries of life has naturally meant a diminution in the proportion of the whole population which has to be employed in agriculture, and a setting free of a larger proportion for supplying other and more refined wants. Yet when has mankind been without weeping and wailing over "the decay of agriculture"? The greatest sign of human progress has been constantly treated as something to be deplored and, if possible, prevented.

If progress, when it requires absolute or comparative reductions in the number of persons employed in particular trades, affected all countries equally, there would be much less resistance to these reductions. The ordinary person generally knows little of what is going on in other countries, and constantly assumes unconsciously that a change which he sees proceeding in his own country is not in fact going on in other countries. But he can be told, and it is often a great comfort to him when he is certain that some symptom indicates that his own country is going to the dogs, if he can be assured that other countries show the same symptoms in equal degree. But of course progress does not affect countries equally, and consequently we have not only redistribution of mankind between different occupations, but also redistribution of the persons following each particular occupation between the various countries. Invention of new methods of transport, coupled with the more general provision —by accumulation of capital—of the material machinery required to utilize the invention, is the most obvious of such causes. It has made it possible and desirable to redistribute agriculturists and manufacturers, reducing the proportion of agriculturists and raising that of manufacturers in the old countries, while not doing so or not doing so in the same degree in the new countries.

But changes in transport are not the only things which affect the distribution of industry. Technical changes in the industries themselves, the exhaustion of old sources for the supply of raw materials, and the discovery of new sources, developments in education and a host of other things, are constantly making it desirable that particular industries should grow more slowly, cease to grow, or even decline in some situations, while they grow or grow more largely in others. The general tendency in history has been towards greater and greater territorial division of labour or localization of industry—that is to say, greater concentration of particular kinds of work in particular districts. To put a larger proportion of an industry in one place obviously involves leaving less in another, so that concentration is necessarily accompanied by denudation—as an industry gets localized in some districts, it declines in others. So long as this process takes place within the confines of a single national area there is little or no complaint. We hear nothing of the calamitous situation of the south-eastern counties owing to the disappearance of the iron industry from the Weald, nor of the misfortunes of Wiltshire owing to the woollen industry having increased more rapidly in Yorkshire.

But when the redistribution is not between different districts of the same national area, but between different national areas, popular feeling is quite different. Then in each national area or country concentration is regarded with favour so long as the concentration takes place in that country, while the denudation is deplored and usually obstructed by Government. Each country is quite willing to accept any increase of industry due to the increasing concentration, but is unwilling to accept the necessary denudation. The various publics fail to realize the very elementary fact that it is just as true of any number of human beings as it is of one, that if they give a larger proportion of their time to one kind or a few kinds of work, they must give less to the other kinds. If an industry is concentrated in a country, it means that the inhabitants of that country deliberately make more of something or other than they want themselves in order to exchange the excess for something else which is provided by the inhabitants of other countries. If they change their minds and resolve to make these other things for themselves they must willy-nilly give up concentration on the

first lot: they cannot have time to make both, and they do not require both. Thus, local or national increase of an industry due to greater concentration must necessarily be accompanied by local or national decline of some other industry or industries.

The war is likely to form an important landmark with regard to both general and local declines.

Firstly, let us consider its relation to general declines. The extreme urgency of the case when whole peoples have imagined themselves, generally without grounds, to be fighting "for their lives," or at least "for their national existence," has led to the overcoming of much resistance to easier methods of production. It is one of the cruellest ironies of the war that hindrances of this kind should have been easier to remove when people were struggling to destroy each other than when they were peacefully co-operating in the production of things generally desired. But so it is, and many authorities hope that the gain made in this direction may offset—at any rate, to a large extent—the loss caused by the destruction of life and limb and by the check to the accumulation of new instruments of production. Various schemes are being mooted for securing that resistance to this kind of improvement shall be less in the future than it has been in the past.

My impression is that a good deal of useless advice is being given. Employers are told that they have been wrong in not allowing the employed to reap the benefit of changes which reduce the amount of labour required to produce particular articles. This would be right enough if the employers were able to keep the advantage to themselves; but what actually happens in the long run—and usually in a not very long run—is that the advantage of a less costly form of production is secured by the purchasers of the product in the shape of a reduced price. Improvements in the production of an article thus cheapen the article while leaving the remuneration of the producers at the accustomed level compared with the remuneration of producers of other things. This surely is the common-sense solution: if a thing becomes easier to produce let it be produced in greater quantity and be cheaper—do not pay the producers more. There seems no real ground for paying them more, and to do so is practically impossible because of the difficulty of selection. If potato-growing is made twice as easy by some invention,

it would be not only senseless to say potato planting and digging was to be higher paid, but futile, unless you give some kind of monopoly to a limited class and face the difficulty of saying who is to be admitted to that class. Otherwise, there will be enough independent potato-growing to keep down the price to a figure which will not yield the proposed extra remuneration.

The real cure seems to be the simple one of greater versatility. The resistance to improved methods comes from the reluctance which people very naturally feel to agree to anything which involves a diminution of the demand for the particular kind of labour which they can offer. To get rid of this reluctance altogether is of course impossible, but its force will be diminished by every increase in versatility which makes the maintenance of demand for the particular kind of labour less vitally important to the persons concerned. And here I see one of the very few good effects of the war which I personally have been able to recognize. It does seem as if the war will have enormously increased the versatility of the present generation. The amount of change of occupation has been enormous, and in consequence quite a large proportion of men and women, who before were only experienced in one kind of work, are now experienced in two, three, or even in more kinds. Moreover, every one is accustomed to the idea of versatility, and convinced that it is much easier to acquire the skill necessary for most occupations without either training in youth or a very long training in later life. This, I think, is one of the most hopeful features of the present situation. Old stick-in-the-mud Europe has, in respect of this matter, become one of the "new countries" which owe so much of their superiority to the greater versatility of their inhabitants.

Trade Unions will have to accommodate themselves in some way to the psychological change which will have taken place. When men become more versatile they will not feel so much identity of interest with an organization representing a small branch of industry and nothing else. To be useful, labour organization must represent persons and not an abstraction. The union which represents a trade no longer necessary to society is of no further use. The general shake-up of the war in making these facts more obvious will undoubtedly be beneficial, though an outsider may be excused from offering suggestions about the

manner in which labour organization should meet the case. I expect it will find a way.

With respect to the other branch of the subject, resistance to *national* contractions of particular employments, which is the branch with which we are concerned, the prospects of mankind do not appear so unclouded. The war has inflamed slumbering tribal animosities and has created pseudo-tribal animosity between most of the people who happen to live in the dominions of the two sets of belligerents, whatever their race may be, and animosity is unfavourable to clear thought and prudent action. We need not indeed attach much importance to the insensate ravings of banqueters who break the plates in an English hotel because they were imported from Germany before the war, or of their friends who wreck the shop of a baker who is fighting for them in France, because his wife employs a German to fill his place in his absence—a German who, in all probability, left his native country because he was not enamoured of it. Such froth will soon disappear. The memories of nations are short—so short that in the past only a few years have usually been requisite to turn enemies into allies and allies into enemies. The plate-breaking heroes of the Savoy probably thirsted for war with Russia over Penjdeh and the Dogger Bank incident, with the United States over the Venezuelan boundary and with France over Fashoda; and the wreckers of the bakery might easily be led against any foreigner who presumed to provide them with any of the necessaries of life. But it does seem as if the present war has been more successful in exciting lasting animosity than most modern wars. A generation or two must pass before the sufferings and indignities endured by the people of areas occupied by hostile armies will be forgotten. The London school-children slaughtered outright by the German aviators, and the Karlsruhe school-children slaughtered outright by the British and French aviators, may be forgotten in a few years, and their graves be untended like those of their fellows who die from natural causes or poverty and neglect, but those who were only maimed will continue for the remainder of their lives to excite the indignation of their compatriots against the cruel enemy. We cannot doubt that hostile sentiments between enemies will be acute for a long time, and it seems to me that it would be sanguine to suppose that its effects will be

anywhere near counterbalanced by growth of affection between allies.

Nor is this matter of sentiment the only disquieting factor. There are others perhaps more practically important.

In the first place, the war has forced most countries to be more self-sufficient than they were. The self-sufficiency has been disagreeable enough to the people who want the imported articles and have had to put up with inferior and much dearer substitutes, but it has favoured those who produce these substitutes, and they rather naturally desire to stick to what they have gained. The position is just the same as it was in this country at the end of the great war a hundred years ago. The agriculturists then had got used to receiving enormously high prices, and they could not bear the idea of a drop on the conclusion of peace. They therefore persuaded themselves and the legislature that the salvation of the country depended on keeping the price of wheat up to 80*s*., and obtained legislation intended to secure that object—legislation which was happily unsuccessful, and had little result except some aggravation of agricultural depression. We see now in the papers paragraphs headed "No more cheap foreign glass," giving accounts of the determination of persons concerned in the manufacture to prevent their fellow-citizens from buying an important building material, not from the enemy but from the Belgians. There is nothing new in this: one effect of war always has been to provide temporary protection for industries which thereupon clamour to have the protection made permanent, and have usually some partial success followed by reaction later.

Secondly, the State, in this and other important belligerent countries, has succeeded in securing the support of labour organizations and thus nationalizing in a certain degree the labour movement. Finding it impossible to make head against their enemies without better support than that afforded by the usual organs of Government, the States have struck up alliances with the trade organizations and have used them freely for the purpose of allaying—or, at any rate, smothering—discontent. The most cherished prejudices of the governing classes have been jettisoned in view of the paramount necessity of winning the war. Lord Willoughby de Broke is alleged to have sung "The Red Flag," German army commands are said to have fraternized

with trade union secretaries, and Cabinets undoubtedly consist of the most amazing compounds of "prancing ex-proconsuls" and "pestilent labour agitators."

The bringing in of Labour to national governments at the moment when these governments are engaged in an immense military conflict of absorbing interest is a most inauspicious event. You know how men who work for an organization of any kind are apt to put the good of the organization before the end for which it was founded. Persons in the service of the State are specially inclined to this. I have many friends who have temporarily given their services to the State, and I have been astonished at the rapidity with which most of them become identified with the machine which they imagine themselves to be working, but which really works them. For three long years the machines which are each called by their subjects—subjects is the right word—"The State," as if there was only one State in the world, have been working not to create but to destroy, and those who have been tending them will have greatly lost their perception of the true ends of life. Thinking perpetually of warfare, they are sure to shrink from allowing the people of their respective countries to increase their "dependence" upon the people of other countries by the increase of international commerce. A good example of the manner in which evil associations obstruct clear thought was given us last spring when one of the new Labour ministers declared that he would not allow any foreign steel to come into his country till all the steel works in it were fully occupied. There was in his mind not the smallest consideration of the question in what proportion it is really desirable that the world's production of steel should be divided between the various countries, but just a thoughtless acquiescence in the standard provided by the number and magnitude of the steel works which happened to be present in his own country early in 1917. Why 1917? Why not some other year? Is it true that not only that what is, is right, but also that it must never be changed?

Can nothing be done to cope with these sinister influences by cold reasoning? Possibly something. It may do good to point out the absurdities involved in the belief that concentration of particular industries in particular countries is undesirable, or at any rate that its extension beyond that already attained in

1917 (or whatever is the date of the controversy) is undesirable. It may do good, too, to point out the extreme unsuitability of existing national areas to be economic units, each striving for self-sufficiency. If the world is to be divided into units striving for self-sufficiency, surely the division ought to be made by a boundary commission of economists, trade unionists, or such other persons as we may suppose competent to order industrial matters. The present national areas were never marked out by such people. They have come down to us from feudal times, have been modified by modern wars and have no claim whatever on economic grounds. If you took the map of the world and tried to divide it into suitable areas for self-sufficiency you would find yourself enlarging the first country you took in hand and enlarging it more and more till at last there were no others.

The cult of national self-sufficiency is incompatible with peace, since it must inevitably render warfare perpetual by making it necessary for each nation to grab territory which contains the source of some product which it has not got in its existing territory and which it must have in order to be self-sufficient. We have seen a little of this already; it would be more and more serious, the more intense the worship of self-sufficiency. Supposing the bigger empires managed to settle down to an uneasy peace, what would become of the smaller countries? What is to become of Denmark, Switzerland, Portugal, when the big countries reached a high degree of self-sufficiency and would not deal with them? They must join the bigger countries, and soon there would be only two or three great powers in the world which, after a second or third Armageddon, would be reduced to one by some struggle for the source of some indispensable article.

Such arguments may seem telling enough in the countries which are too small to allow the lust of power to flourish. But in the greater empires they are likely to fall on deaf ears so long as the present state of sentiment prevails. In each of these, people will be found to believe that their own country is the best situated for the struggle. In the large scattered empire of which the parts are separated by long distances over sea, people think they can best be independent of outside supplies because their dominions extend into every zone of temperature and

include every kind of soil. In the smaller but compact empire the weaknesses of the larger but more scattered one—its liability to succumb to submarine attack, for example—are clearly perceived, and it is hoped that the more compact area will win through with the aid afforded by science in providing substitutes for imported products. So long as the question is considered from a purely national point of view, and so long as patriotism is confounded with contempt and hatred of other nations, we may doubt if argument directed to show the suicidal character of the gospel of self-sufficiency will have much effect in the greater countries. When two men desirous of killing each other are locked together in the water, it is not much use to tell them to let go if each thinks the other will drown first.

Even, however, without any expectation of cold reasoning about either exclusive or mutual advantage producing much effect in the present state of international sentiment, we may hope for some improvement owing to the discredit into which the more important belligerent States will have fallen by the end of the war. The war is no longer popular in Europe, though it is said to be so in America, where it is only beginning ; it will be less popular before it ends, and in the appalling slump which will follow the inflation by the aid of which it has been carried on, it will be universally execrated. The independent States are responsible for it, and none of the greater ones can escape responsibility by pleading that it was not their fault but the others', since, if they did not want the war, they ought to have taken more efficient steps to prevent its occurrence. Moreover, they have each saddled themselves with a load of debt, made much greater than it need have been by their insensate issues of paper money which have raised prices against them, and quite impossible for most of them to bear. Break-downs under the burden will deprive them of the one and only means by which modern wars can be carried on, while continued bearing of the burden will involve taxation wholly incompatible with popularity. Some of the existing States will probably disappear altogether, and those that remain will find their power immensely reduced. The Labour movement will cease to regard the capture of such discredited institutions as an object of desire, and will not only be thrown back into greater reliance on its own organizations, but will also tend to make those organizations, wherever possible,

ignore national boundaries. This will greatly weaken the forces which resist necessary and desirable redistribution of industries between different countries. An organization representing that part of a trade which is situate in a single country can scarcely fail to support any measures which will prevent its being superseded by greater growth in another country. But an organization which represents both parts of the trade will regard the transfer with equanimity.

All this might be urged even if no fundamental change in our political system were impending—even if it were likely that we should be content after this war to sink back into the old condition of preparing for the next one. For my part, however, I regard that as a state of things which, if possible at all, could only endure for a very short time. The possibilities of preparation are now seen to be so great that preparation for the next war would mean the giving up by the whole population of every kind of commodity, service, and enjoyment beyond the very barest necessaries of life. No people will stand that, and the inevitable consequence will be the introduction of some kind of world-government which will put an end to what is called national independence—that is, the right to go to war claimed by the present national States. These States, or those of them that remain and the others that take their place, will then drop into the relative position which different Dominions of the British Empire at present occupy in regard to each other, and we may derive some useful ideas from the parallel.

Though the different Dominions of the British Empire have no right and (perhaps therefore) no inclination to go to war with each other, they seem at first sight to show much the same desire for self-sufficiency as independent countries, and obstruct trade in much the same way.

Therefore, it may be said, the different countries in a Worldish Empire in which autonomy without power to go to war was established would adopt much the same commercial policies as they do at present. But we may well doubt whether, if this were true at first, it would continue to be so for any length of time, for two reasons. In the first place, the tendency of the British Dominions to strive for self-sufficiency is much less marked, and is becoming less and less so, in relation to other parts of the British Empire, than it is in relation to foreign

countries with which the possibility of war is present. In the second place, it is likely that such cult of self-sufficiency as really prevails is largely due to unconscious imitation of the independent and war-making States. In a Worldish Empire there will be no foreign countries, and the tradition of the war-making States will be gradually dying. Consequently, from the first, we may expect a less vigorous adoption of obstructive commercial policies, and as time goes on we may reasonably expect it to become further and further relaxed.

III

THE CAUSES OF DISCONTENT

[An article entitled "Industrial Unrest" in the *Economic Journal* for December, 1917. The Commission's reports referred to are numbered Cd. 8662 to 8669. The word "flipper" (in the first paragraph) was invented by me as the masculine of the well-established "flapper" to describe the pert but capable boys who took the places of absent men, but deliberate efforts to enrich a language are seldom successful. A committee in Whitehall, on the motion of Professor W. J. Ashley, excised the word from a draft report in which I had managed to introduce it.]

In 1914, when the war broke out, a wave of patriotic sentiment led the well-to-do citizens of this country to resolve to do something to prevent the poor from suffering too much. They proceeded to collect money for the relief of the distress which was expected from want of employment, and we can well remember the exultation felt when the aggregate reached a sum which would pay for about half a day of the war at the present rate. The expected unemployment did not arrive. Instead, employment became more complete than ever before. The unemployment percentage curve sank almost to the base of the chart: old-age pensioners were dragged from their retirement; thousands of "flappers," girls in their early teens, left their trivial home tasks and peopled shanties run up for Government departments in St. James's Park and the Embankment Gardens, and hundreds of thousands worked in munition factories everywhere, while their brothers, the "flippers," got promotion at a rate which suggested that Father Time must have taken to an aeroplane. Wages in the new occupations were very high, and even in the

depressed trades "war bonuses" had to be given to retain a much diminished number of workers. So far as money receipts were concerned, the working-classes never had such a glorious time.

And yet not quite three years after the beginning of the war a Commission was appointed by the Prime Minister to "inquire and report upon Industrial Unrest and to make recommendations to the Government at the earliest practicable date," and its work was considered so urgent that it divided itself into eight divisions (corresponding to the eight munition areas), and these eight all reported in a month!

With the aid of the Commissioners' reports it is not very difficult to see what the main causes of the unrest have been.

In the first place we may take the loss of individual liberty. Of course, many of the restrictions imposed by war measures, while irritating enough to the people in general, can scarcely be regarded as causes of "industrial" unrest, inasmuch as they are not directly connected with employment. Such are the liquor restrictions, and the fact is probably the explanation of the sharp divergence of opinion between the various panels of the Commission when they ask themselves whether the liquor restrictions have been a cause of industrial unrest. The West Midlands Commissioners "were frankly amazed at the strength of the objections to the liquor restrictions," and recommend that the supply of beer should be largely increased. The Scotch Commissioners, on the other hand, received no complaint from any quarter; and the North-Eastern Commissioners find that "the liquor restrictions have not generally led to the creation of industrial unrest"; while the North-Western Commissioners very confusedly announce that they "are a cause of unrest," but "contribute to unrest rather than cause it," and quote with approval the observation of an employer, "I should not call the liquor restrictions a cause of unrest, but I should unhesitatingly say they are a source of a considerable loss of social temper." The Commissioners in general adopt the view very naïvely expressed in the North-Western report, that "the matter should be sensibly dealt with, not from the high ideals of temperance reformers, whose schemes of betterment must be kept in their proper place till after the war, but from the human point of view of keeping the man who has to do war work in a good temper,

which will enable him to make the necessary sacrifices in a contented spirit," beer being to many of the best citizens of the country "not only a beverage, but a sacred national institution."

Conscription appears at first sight not to be a distinctively industrial matter, any more than the liquor restrictions, but it becomes so in consequence of the necessary exceptions to its universality. The loss of liberty involved in every man of a certain age being compelled to serve was a popular loss among almost all classes, because the man of military age who was not willing to serve was disliked, but whether or not, it could not have been a cause of specifically industrial unrest. But when it was found that universality was impossible, and the loss of liberty took the form of tribunals deciding who was to go and who to stay, the situation was completely altered. Decisions that this man and that man, though of military age and fitness, shall be allowed to stay at home in safety because they are indispensable to the industry in which they are employed are and must be industrial decisions, and, human nature being what it is, they are absolutely certain to become a cause of industrial unrest. Moreover, the Army itself, though its efforts are directed to the destruction of the enemy, is an industrial organization, and offers great variety of occupation: the selection of men for the various occupations is entirely in the hands of the military authorities, and would be far from giving universal satisfaction, even if those authorities were perfectly wise. As things are, it is not surprising to hear from the Scotch Commissioners that "the whole system of the operation of the Military Acts is, in the opinion of the great bulk of the working-classes, an exhibition of bungling incompetence and of exasperating dilatory methods," and that the opinion generally held of the unfair working of the Acts is "a great cause of unrest."

While willing to submit to the loss of liberty involved in universal military service, the working-classes to a man were strenuously opposed to "industrial conscription." Now it is true that no man has been industrially conscribed in the sense of being directly compelled to take some particular employment, but a great deal of what may be called negative industrial conscription has been introduced by restricting men's freedom to abandon their employment, either by way of strike or in order to take other employment. As the West Midlands Commis-

sioners say, "The Munitions of War Acts have revolutionized industry. In normal times the workman is free to leave his employment, whether to secure better wages or on personal grounds; now he can do neither unless his employer consents or the Munitions Tribunal grants a certificate. . . . In normal times wage changes are settled by collective bargaining; now they are settled by the State. In normal times the employer disciplines his own men; now discipline is enforced publicly in a criminal court. Lastly, the Trade Unions have fought, rightly or wrongly, and in the engineering trades have fought successfully, for the principle that certain men or certain unions alone were entitled to certain work. Now this has been swept away, and men and women of rival unions, or of no unions at all, work alongside skilled craftsmen. These changes are strongly resented as infringements of personal liberty, to which men are deeply attached."

Historians tell us that the people of England in old times bought their liberties with hard cash. In our day surprise and annoyance has been expressed in some quarters at the unreadiness of the workmen to sell their industrial rights. Patriotism and pelf, they have been told, both demanded that they should make no fuss about such things: the one thing needful to them was to beat the Germans, and they should be thankful for the high wages which they were able to earn for doing it under, and it was implied, in consequence of, the new system. The appeal to patriotism has kept things going; the appeal to pelf has largely failed.

One great reason for its failure has been, of course, the rise of prices, which has made the rise of wages to a large extent illusory and disappointing. The ordinary person's feelings are outraged by any change in prices which tells against him much more than they are gratified by a change in his favour. If his wages are doubled at the same time as the prices of the things he has been accustomed to buy rise one-half, he will not be thankful for the actual rise in his real wages, but will be infuriated by the belief that somebody has cheated him out of part of his rights. Thus even the large section of the working-classes which has really so far without doubt benefited greatly by the war changes might quite reasonably have been expected to be extremely discontented, as well as those whose position was left

substantially unaltered and those who have been actually damaged. The eight panels of the Commission are unanimous in regarding the opinion of the working-classes, that they have been exploited by the rise of food prices, as the universal and most important cause of industrial unrest.

The other great reason for the failure of the rise of money wages to placate the wage-earners has been the fitfulness of its distribution. A community which would be quietly contented with a 10 per cent. rise of income all round and happier still if the same aggregate increase arrived in the shape of an equal instead of a proportionate addition to each person's income, is likely to be thrown into a seething ferment of discontent by a 20 or a 50 per cent. rise distributed haphazard. The war changes have not only altered the distribution of earnings between different industries, but have altered the distribution between different classes of workers inside each industry at haphazard, so that individuals working in the same shop have seen their relative positions reversed. The dispassionate outside observer sees no reason for supposing the new distribution to be less just or more unjust than the old, but the popular mind is devoted to the doctrine of vested interests and legitimate expectations. If time out of mind one class of labour has earned 20 per cent. or thereabouts more than some other class, it will seem a cruel injustice to the first class if they get a rise of only 15 per cent. while the second gets a rise of 50 per cent., so that the new earnings are 138 and 150 instead of 120 and 100. Nor will their dissatisfaction be anything like balanced by the satisfaction of the class which has risen : this satisfaction will be alloyed by an uneasy feeling that the good fortune is undeserved, and that the unlucky have been badly used. The West Midlands Commissioners say :

" The outbreak of the war found the craftsmen's unions, such as the A.S.E., working mostly on a time rate as against a piece rate. This was the case even where a piece rate was applicable and would have paid the men better. This feature of Trade Union policy is so well known that we need not enlarge on it. The war caused changes which can be grouped under three heads :—

" *First*, the introduction of semi-skilled and unskilled men and women into work previously regarded as skilled men's work.

"*Second*, the largely increased output of existing processes giving a greater earning power for the same piece rate, and

"*Third*, the introduction of many new processes easily learnt and yielding a high wage at the agreed piece rates. To this must be added the great speeding-up which the beginning of the war called out, and the fact that it was very wisely determined that piece rates existing before the war should not be reduced. The result has been as great a revolution in industry as any similar period has witnessed. The output has been vastly increased, old processes have been scrapped, and new and more efficient ones introduced. Our industries stand on a different plane from the pre-war period. Now the effect of increased production coupled with a fixed piece rate has been a great increase of the earning power of workers doing repetition work. The rates were fixed in peace time, when not only were conditions more leisurely, but orders were received in dozens and grosses where they are now received in thousands and tens of thousands. Hence the machine can now be worked for a longer productive period, the output is enormously increased, and the wages earned have reached a height hitherto undreamt of. In the engineering trade four pounds a week for [a] man or woman, who has entered the trade since the war, is not an unusual wage; whilst in many cases the wage reaches six, eight, and ten pounds a week or even more, all, be it understood, by workers with no previous experience. At the same time the tool-maker and the gauge-maker, both skilled men whose skill is the basis on which the machine operates, are still working on a pre-war rate, plus the bonuses and advances received since the war, but, taking all these into account, are receiving considerably less than the piece-worker.

"The result may be imagined. The skilled man with a life's experience behind him sees a girl or youth, whom perhaps he himself has taught, earning twice as much as he does. The injury to his self-respect is as great as that to his pocket His grievance is aggravated by the fact that the Leaving Certificate system prevents him from taking up repetition work himself."

The Yorkshire and East Midlands Commissioners similarly say: "In every district typical instances were given in which unskilled workers, labourers, women and girls, were earning more than double that of the skilled men, thus provoking discontent and acute unrest, not only in the ranks of the skilled

men and in their homes concerning the inadequacy of their pay, but also in the other grades of ordinary unskilled labour, where the earnings of the workers have been but slightly increased, and thus made a demand for higher rates of pay, such as would provide the bare necessities of living at the present exorbitant prices.

"The methods followed in fixing the prices for the piece-workers appear to have been of a very haphazard and careless character, arrived at generally without conference with those who could have suggested more scientific and equitable methods of securing that the greatest output could have been ensured by advancing skill and the employment of new and improved means of production. Unskilled workers in some factories are earning from £10 to £18 per week, and could easily earn more but are afraid to."

The discontent which exists takes the form of anger with the Government, not in the sense of the particular group of politicians who happen to form the Cabinet or the Ministry, but the whole machine. The Government is directly employing an astonishingly large proportion of the whole population, and a large proportion of the remainder are employed by firms which are mere puppets in the hands of the Government. We hear no more of grandmotherly legislation: dropping that, the State has become the Grand-employer, and the employees do not like it in that capacity. The Commissioners for the North-Eastern and the South-Western divisions, indeed, do not seem to have been much impressed by the feeling against the Government, but the other six panels have no doubt of its strength and importance. The machine is regarded as slow, stupid, and untrustworthy in all the six divisions. The two of them which have the most independent life of their own—Scotland and Lancashire—think it too remote, and demand more local autonomy; but in the London area, within easy call of Whitehall, there is but "a fading confidence in Government departments," and "a distinct opinion amongst both employers and workmen that the Government has intervened to a much greater extent than is desirable or useful in the relations between employers and employed"; in the West Midlands the distrust of Government "is both widespread and deep"; in the Yorkshire and East Midland division, not only the skilled engineering and

electrical trades, but members of a dozen less skilled unions "all alike without a single exception expressed distrust in, and total indifference to, any promise the Government may make, while some referred to 'Russia,' and openly declared the one course open for Labour was a general 'down tools' policy to secure reforms that constitutional action was failing to effect"; and the South Wales Commissioners say: "An outstanding feature of our inquiry has been the unqualified hostility on the part of witnesses, both on the men's and the employers' side, to Government interference."

There are many references throughout the report to the fact that the national trade unions are sharing in the loss of popularity suffered by the national government. This is due in part to the association of the union authorities with the Government in measures which have turned out badly, and partly to the greater appreciation, at a time of very rapid movement, of the slow and cumbrous nature which characterizes action through national unions as well as action through national government. Hence comes a preference for shop organizations in which the rank and file can act immediately when occasion arises. This looks like anarchy to the old-fashioned labour organizer, and many employers are beginning to look back with regret on a golden age when labour leaders were real gentlemen whom it was a pleasure to meet, and who possessed complete control over their followers. The Commissioners are mostly puzzled by the development, which, after all, is probably only a step in the progress of individual liberty: the workers' position having become really less servile, action by small sections in accordance with their immediate circumstances has become possible, and the protection afforded by vast and cumbrous organizations is less universally necessary.

The findings of the Commissioners on the causes of unrest seem more interesting, and likely to be more fruitful than their recommendations. The findings not only present a snapshot picture of the industrial conditions prevailing at the end of the third year of the war, which will be a cherished possession of the future historian, but also should greatly assist anyone whose business is the amelioration of those conditions. In recommendations, however, it can scarcely be expected that Commissioners appointed and reporting in a month should be able to suggest

anything which is important and valuable without being obvious. The Government of this country, like that of others, has made itself a very uncomfortable bed, but it has got to lie on it till the termination of the night, which, it is to be hoped, is not now far distant. By a little shifting here and there the uneasiness may be slightly alleviated, but that is all. So we find a very large number of recommendations which differ in detail and relative emphasis between the eight reports, but which might be summarized in the advice, "remove causes of friction as far as possible and as quickly as possible by whatever means seem to be locally desirable, but do not imagine that you can do it by breaking pledges, even when they have led to great difficulties."

But there is one exception to the general tameness of the recommendations. With regard to food prices, the eight panels are unanimous in thinking that something must be done. The Scotch Commissioners are cautious. They say that "on the whole amongst industrial workers there is no serious difficulty in meeting the cost of living, at least among the workers engaged in the largest industries in Scotland. The experience of shopkeepers and co-operative societies, the reduction of cases in the Small Debt Courts, the savings banks returns, the reports of Poor Law authorities, etc., seem to indicate that, on the whole, the aggregate weekly incomes of industrial workers keep pace with the cost of living." They hint that much of the discontent in regard to the matter is fostered by misleading statements in the Press, and they only conclude that it must be "*promptly* dealt with, in the direction of either (*a*) taking steps to reduce the cost of the necessaries of life; or, if this is not possible, (*b*) convincing the public that the prevailing high prices are inevitable," without suggesting any method for securing either of these alternatives. The West Midlands Commissioners say "it is absolutely necessary that the Government should take immediate steps to reduce prices and prevent profiteering. We shall no doubt be told that this is an easy thing to say but difficult to do. We are, however, not concerned to find a remedy, which is the business of the Food Controller, but we are concerned to point out that the present uncertainty and confusion are doing untold mischief, and that the question should be tackled at once in a resolute manner." The London Commissioners recommend a simple fixing of maximum prices, and the North-Eastern and the Yorkshire Commis-

sioners do the same, but add that Exchequer assistance must be given where necessary. The remaining three panels show a little more appreciation of the problem. The South Wales panel tried to find out " who and what causes are really responsible for the great increase in the cost of our food supplies," but found themselves " largely baffled " in their efforts, though they had to " exonerate " retailers, shipowners, and bakers. It was " suggested " to them, and they were " inclined provisionally to adopt the view, that the major part of the increased cost of food is due in part directly and in part indirectly to the destruction of tonnage by enemy submarines." To show the effect of this destruction they point out that 25 per cent. insurance on a ship worth £150,000 with a cargo insured at £50,000, total £200,000, is 100 per cent. on the cargo. They think it wrong that the loss should fall upon the consumers of food, and that it ought, instead, to be " met and provided for in the same way as all expenditure directly incurred in prosecuting the war." That is, by an immediate increase of taxation or by an increase of borrowing with greater taxation to follow, but the panel's only suggestion for new taxation is that " all excess profits derivable from the sale and distribution of commodities for home consumption should be appropriated by the State." They seem very much pleased with this proposal to abolish " the incentive to charge inflated prices for such commodities," while leaving the merchant with a 20 per cent. of excess profits inducement to serve the foreigner rather than the home consumer. When he sells to the foreigner this panel, consisting of Messrs. Lleufer Thomas, Thomas Evans, and Vernon Hartshorn, who vaunt their absolute unanimity, take us clean back to the beginning of the seventeenth century by lauding his operations as " the bringing of wealth into this country." On page 36 they place the phrase " to bring wealth into the country " in inverted commas: the quotation might be originally from Mun's *England's Treasure by Forraign Trade*, but the context suggests that it has been taken immediately from some twentieth-century Cardiff shipowner. Other proposals of this panel are that the Government should " stamp out all profiteering " in food, buy all imported food supplies as near as possible to the point of production, and fix the prices to be charged by the wholesaler, the middleman, and the retailer, while " in the event of its proving impracticable to bring about a sub-

stantial reduction in the cost of living, wages in all the lower-paid industries " should " be increased proportionately to the increase in the cost of living."

So far we can trace no recognition of what seems the very obvious fact that if there is less to eat somebody must eat less and that the real problem is how to distribute the inevitable hunger in the manner which will cause least suffering on the whole. The Commissioners insist on regarding high prices not as an incentive to greater production and importation and a discouragement to waste and lavish use, but as if prices were themselves the root-cause of the trouble, and must be beaten down without thought of the effect of their suppression. If they cannot be so beaten down, the South Wales panel add, the lower-paid classes of the population must be given as much money as will enable them to buy as much of the commodities as they used to buy, in spite of the shortage; that this (as Malthus showed in 1801 in his pamphlet on *The High Price of Provisions*) must cause a further enormous rise in prices, and, if the principle be followed out, a further and more extended application for increase of money wages followed by another rise of prices, and so on, *ad infinitum*, does not occur to this panel.

The South-Western report, which bears the signatures William W. Mackenzie, Alfred Booth, and T. Chambers, attributes the rise of prices to the inflation caused by the Government relying too much on loans and " too little on taxation designed to check unnecessary consumption, and, latterly, to the actual shortage of supplies." The only way to stop further inflation and the rise of prices resulting from it is to raise more by taxation; the taxation thought of seems to be increase of income-tax and super-tax. To get rid of the shortage, losses by submarine must be diminished and more ships built. The report continues:

" Inflation and real shortage inevitably produce conditions favourable to what is commonly called profiteering, which is really only a symptom of the disease from which we are suffering. Treatment of the symptom may produce some alleviation, but cannot effect a cure. The danger of fixing prices for any commodity is, of course, that the supply may cease. The general rule, therefore, should be not to fix prices unless the whole supply is controlled. When this can be done the control should extend from the field of production to the shop-counter, and intermediate

charges should be limited to a fair remuneration for services rendered."

This gets nearer the kernel than the other reports. It recognizes that the high prices are partly caused by people having more money to lay out (owing to the inflation), and partly by there being a less quantity of commodities available for sale, and also that the high prices encourage supply. But it does not squarely face the fact that the inflation portion of the rise in the price of the more necessary articles comes particularly from the increased money-means of the working-classes; an increase of money-means in the hands of the wealthy does not lead to any appreciable increase in the demand for and price of the "necessaries of life"—it leads almost exclusively to increase in the demand for and price of luxuries and of articles in which the money of the saving rich is "invested," or "capital goods," as they are sometimes called. Consequently the South-Western Commissioners rather weaken their case for more taxation when they suggest increase of income-tax and super-tax, coupled with greater allowances for families, which is presumably what is meant by "a comprehensive reform with regard to the treatment of family incomes"; it is not taxation of those with the largest, but those with the smallest, margins over absolutely necessary expenditure which will most tend to reduce the prices of necessaries. Further, while observing that price calls forth supply, the report fails altogether to notice that it also arranges for the distribution of the commodity priced. When a commodity is sold for what it will fetch, each of a number of persons buys as much of it as he wants at that price, and there is enough to go round; when it is sold compulsorily for something below that price, people want (at the new Government price) more than there is, and there is no longer enough to go round, in the sense of each person getting as much as he asks for. Even the populace is beginning to say: "It's a queer thing that whenever the Controller fixes the price of anything you don't seem able to get it." It is not that everybody does not get it, but that some do not. Those who get it are those who arrive first to take their places in the queue, those who are most in favour with the seller because they buy plenty of other things, those who make no complaint of quality, and so on. The distribution resulting from the ordinary working of unrestricted prices is undoubtedly bad in enabling

the rich to buy more than the poor with equal wants, but it is good in enabling persons of equal means to obtain the unequal quantities required to give equal satisfaction to their unequal wants. Those who wish to do away with it, therefore, should first devise something better to take its place.

The North-Western Commissioners alone among the eight panels have grasped this truth. They have not got it from the elementary economic textbooks, but from the hard teaching of experience furnished especially by the Government treatment of sugar, about which they quote with evident approval the opinion of witnesses that the real value of the experiment is as "an example of how not to do it." Having complete control over the distribution of sugar, and having less to divide than the people had been accustomed to, what did the Government do? It might, of course, have sold the diminished quantity for what it would fetch. A very large sum of money would have been raised by this course, and that would have reduced the necessity of borrowing. Complaints of profiteering would have been less, because, while they could not have been made with regard to sugar, the increase in the amount of the money-means of the people absorbed by the purchase of sugar would have diminished the amount of money they could offer for other things, and thereby tended to keep prices down. So far as people of equal means are concerned, the distribution would have remained just as good as in ordinary times, the higher price simply tending to cut off waste and the least necessary consumption. So far as rich (with whom for this purpose must be lumped their indoor servants) and poor are concerned, there is at any rate very little reason for assuming that the distribution would have been materially worse than in ordinary times. Some wealthy persons no doubt would have gone on buying as much as before, thus leaving a smaller proportion of the diminished quantity to the rest of the people. But where is the evidence that this alteration would have been of any appreciable magnitude? It is too often forgotten that while it is easier for the rich to continue to buy their accustomed quantity of a commodity which has become more expensive than it is for the poor, it is also easier for them to reduce their consumption than it is for the poor. Results will be different in the case of different commodities; so far as sugar is concerned, it seems highly probable that the reduction of

consumption owing to the pressure of high price, coupled, as it would have been, with appeals to patriotism, would have been somewhat greater among the people of more than the average income taken as a whole than among those below that level, so that the poor would have had a larger proportion.

The Government did not take that line, nor does it occur to the North-Western Commissioners as a possibility. The plan adopted was to hand out the sugar, at a price much below what it would have fetched, to grocers in the proportions in which the total was divided just before the war, and to insist on their selling it at retail prices corresponding to the wholesale prices charged by the Government. It is characteristic of the British Government to forget the possibility of change, and to ignore it when it actually occurs. The distribution was already out of date when it came into force, and, of course, became rapidly more and more so. In the great changes caused by the war there was much shifting of population; the areas with an increase, which were predominantly areas producing urgently required munitions, were obviously much worse served with sugar than the areas which had been denuded of a large portion of their population. But this was not the only worsening of distribution. The Government had indeed ordered the grocers to sell at prices far below what the sugar would fetch, but it had given them no guidance on the question to whom to sell and in what proportions. Officials and politicians might believe in the rule of "as in 1913" being applied to 1915 and later years, but grocers are more in touch with life, and were not likely to suppose that they could deal out sugar on that principle to a population undergoing a shifting unexampled in modern history. The ordinary grocer could not put his customers on equal rations for two reasons. In the first place, he had generally no knowledge and no effective means for acquiring knowledge of the exact number of his customers and their households. Secondly, even if he had that knowledge, he could not enforce equal rations unless he refused all new customers: a grocer who, himself rationed "as in 1913" by the Government, gave equal amounts to all customers would be compelled to reduce the ration every day as the news spread and his customers daily increased in number. The co-operators, who are a slightly more exclusive body than the customers of an ordinary grocer, seem to have tried this plan, and to have had a

great increase in membership, with the result that their equal ration has apparently fallen below the *per capita* amount available for the whole population. It is easy to go to a new grocer, and not very difficult to join a co-operative society, while continuing to buy from your original grocer.

The course actually adopted by the grocers was the best open to them in the circumstances, both in their own interest and in that of the public. Being compelled to become the agents of the Government in giving away sugar for less than it would fetch, they "gave it away with a pound of tea," sometimes in the literal sense of that expression, but more often simply by being accommodating or otherwise, according as the would-be purchaser of sugar was in respect of other things a customer whom it was desirable to placate. That this was the best plan in the interest of the grocer is obvious. Debarred by law from charging more than the fixed price for sugar, he yet suceeded in enlarging his profits as a whole by using the Government gift (provided at the expense of the taxpayers) in such a way as to make him able to deal on more favourable terms with his customers in respect of other goods, and he was only partially deprived of these increased gains by the excess profits tax. To the public the plan was, of course, less satisfactory. The North-Western Commissioners are right in condemning it. They might well have pointed out, not only that it was bad, but that it was much worse than the ordinary practice of selling sugar for what it will fetch. The consumers as a whole, taking indirect payments into account, paid just as much money for their sugar as they would have done under unrestricted prices, and, in addition, endured a large amount of inconvenience and annoyance, while the distribution of the burden of the shortage was considerably worse than it would have been under restricted prices. The wealthy had just as much advantage as usual, for, *ceteris paribus*, the wealthy purchaser is the one whom the retailer finds it pays best to placate. The pushing and unscrupulous of all ranks, with their greater readiness to exaggerate their claims and put pressure on their grocer or grocers, were given an unusual advantage. All this was, of course, on the top of the inequality of local distribution arising from the Procrustean pre-war standard.

But, in the circumstances, could the grocers have served the public better? The popular idea seems to have been that every

grocer should have sold to any purchaser whatever amount of sugar that purchaser chose to proffer the Government price for, and occasionally some simple-minded individual called a policeman to his assistance, and demanded that he should compel the shopkeeper to hand over the required sugar. There was a resolute determination not to face the fact that at the Government price the sugar would not go round, so that the adoption of the principle that the grocer must sell meant the adoption of the queue system of distribution, under which first-comers get as much as they ask for and late-comers get none at all, except by begging or buying from the more fortunate first-comers. The Devonport administration did not see much, but it did see this, and therefore refused to yield to the popular clamour in favour of compulsory sale. It was, however, quite unable to suggest any better plan to the grocers than that which they had adopted, and this inability was shared by all its critics without exception. The grocers had in fact restored the rule of market price as nearly as they could under the regulations, and it was the best they could do.

The Government scheme for sugar was no doubt adopted not to secure an improved distribution of sugar, but an improved public temper. In this, as every one knows, it failed egregiously. The North-Western Commissioners conclude their indictment of it with the words: "If during the coming winter other necessaries of life are controlled and distributed in a like manner the position would, in our opinion, become very dangerous."

They proceed to propose the scheme for improved regulations which has since become familiar owing to its adoption by the Government. Under it the housewife will no longer be able to run from grocer to grocer buying half-a-pound here and half-a-pound there along with other things. She is to be tied to a single grocer (individual or co-operative society) for sugar; on the other hand, the grocer chosen must give her the quantity to which the number of persons she is registered as buying for entitles her to claim. Under this system the gift intended to be made by the taxpayers to the sugar consumers will no longer be intercepted by the grocers and partially restored to the taxpayers by the excess profits tax. It will really reach the sugar consumers, and the taxpayers will recover nothing, but have to

pay the considerable cost of administering the somewhat indiscriminate charity.

Whether the new plan is a good or a bad one is of enormous importance, if the war continues, because the North-Western Commissioners regard it as applicable not only to sugar, but to all necessaries of life, and certain details in the sugar registration forms certainly suggest that Government contemplates the possibility of using the sugar registration for other commodities. We may well doubt whether the confidence of the North-Western Commissioners is not somewhat blind.

In the first place, it seems that they rate too low the difficulties arising from the elasticity of households. Already (in September, 1917) some of these are beginning to be realized by the housewife who thinks of her guests and her day-girl, and, on the other hand, of meals taken outside the home by her husband or her sons and daughters, and we begin to wonder whether the plan is really better than the much more exact German ticket system. Later on it will probably be discovered that the actual elasticity of households has led to much overlapping and consequent double-reckoning of individuals. What statistician would trust a census in which the householder was promised half-a-pound of sugar per week at a low price for every person he entered on his schedule? The "British Sugar Census of 1917" is likely to find a place in future manuals of statistics as an example of inaccuracy induced by bias. Moreover, the longer the register remains in force the worse it will get. Arrivals and births (or is it to be weanings?) are sure to find their way into the register, while deaths and departures will be less promptly and completely recorded. Thus the rule of equal division will be subject to a good many and very undesirable exceptions.

Secondly, neither the North-Western Commissioners nor anyone else seem to have made any study of the question whether equality of division applied for the duration of the war to the distribution of a few of the necessaries of life, each being taken separately, will really be a better distribution than the distribution which results from free purchases at unrestricted prices. It is an economic commonplace that greater equality in the distribution of income is desirable, but that is only because greater equality of income would mean a nearer approach to distribution according to needs, which is the true principle. Further, accept-

ance of the commonplace does not imply acceptance of the proposition that complete equality introduced suddenly and enforced for a limited period only is desirable.

The proportions in which families of equal means need the different "necessaries of life" are very different. In ordinary times they distribute their expenditure among the different necessaries in the way which seems best, some getting more bread, some more meat or milk, and so on. By equal rationing all this variety is done away with; each household is given the same amount per head of each commodity; allowances for age, sex, occupation, and other things can only be introduced with difficulty. An immense disorder is thus introduced into household economy, and, unless the aggregate to be divided is enormously smaller than usual, much waste is likely to occur, as every one with any experience of fairly liberal equal rations knows. This admittedly bad result is supposed to be more than counterbalanced by the improvement in the distribution between families of very unequal means, between "rich and poor," as it is commonly put in popular phraseology by those who think that because the rich are conspicuous and their habitations occupy a good deal of the area of cities they must consume a very large proportion of the necessaries of life, so that it will be an important alleviation of the suffering of their poorer fellow-citizens if such part of their consumption of necessaries as is over and above the average consumption is cut off from them and divided among those who have less than the average. But this belief is unfounded; whether we include indoor servants with the "rich" or not, their excess consumption of most of the necessaries which can be weighed out in equal rations is insufficient in the aggregate to make any important difference to the very much more numerous "poor." Of some necessary commodities, notably bread, the *per capita* consumption of the rich is actually less than that of the poor, and the cynical observer is tempted to suggest that perhaps this is the reason why bread is usually the first thing to which the rule of equal rations is applied—the poor lose by it! There is certainly one great example of a necessary of which the excess consumption by the rich forms an important aggregate, namely, fuel. But it is a striking fact that here the undesirability of introducing equal distribution suddenly and for a limited period has been sufficiently obvious to induce the British Government

in rationing London for coal to adopt the principle not of equal division per head, but of division according to number of rooms occupied, which, of course, varies with means as well as with numbers of persons in the household.

While compulsory rationing on any principle is probably inferior to the voluntary rationing enforced by rise of price, we need have little doubt that the sugar scheme sketched by the North-Western Commissioners and adopted by the Government is a better one than the Rhondda plan of lowering the prices of bread and meat, while leaving the restriction of consumption to the War Savings Committee's exhortations and trusting the distribution of the bread and meat to chance. The bakers and the butchers, not selling such a multitude of things as the grocers, are not in a position to put a check on the demand for bread and meat of the kind imposed by the grocers in the case of sugar under the Devonport *régime*, and at present (September) it remains to be seen whether they can devise some other check. If not, we may expect to see bread and meat added to the sugar scheme, the difficulties of which will be thereby much intensified.

Possibly the sugar scheme may do good by forcing people to accept the truth of the proposition that you cannot fill eight pint pots out of a can which holds less than a gallon. Even if there are a considerable number of deadheads on the register, it will still be very obviously true that the ration will depend on the total to be divided and the number, including deadheads, among whom it is to be divided. At present there is a continual mixing up of deficiencies arising from unequal distribution with deficiencies arising from the smallness of the total. Even the Commissioners sometimes fall into this confusion. The North-Eastern panel want staple commodities to be "procurable" at fixed prices, which is clearly just what they cannot be, if, as is of course implied, the fixed prices are below the prices which will just make the commodity go round. The North-Western panel say that "the Wholesale Co-operative Society, which deals in one year with 174,000 tons of sugar to the value of £6,000,000, has not received sufficient rations to distribute to its working-class members and their dependants, who number over 12,000,000." The charitable reader will take "sufficient rations" here to mean the amount which the Wholesale ought to have received, having regard to the quantity to be divided, so that the rest of the people

must have had more than they ought. But, no, the report goes on: "Unorganized consumers have been even worse off, because they have been left to look after themselves."

IV

HISTORY REPEATS ITSELF

[A review of Smart's *Economic Annals of the Nineteenth Century* in the *Economic Journal* for December, 1917.]

The first volume of this work, covering 1801 to 1820, was reviewed in the *Journal* for March, 1911, and the hope was there expressed that the author's fear that he might not be able to carry it much further would turn out to be unfounded. Death cut him short when he had completed ten more years, but the scale of the book was increasing in his hands, so that the decade 1821–30 occupied a whole volume, of which he had almost finished correcting the proofs. This volume presents the same general features as the first. The name "Economic Annals" is still rather a misnomer, as the work continues to be in the main not an account of yearly economic happenings, but a Parliamentary history of economic matters—a summary of Hansard which tells us in a convenient and attractive form what economic facts and theories came under the notice of Parliament, and what statesmen and politicians thought, or at any rate said, about them.

If Smart had been spared to write a preface to the volume, he could not have failed to take the opportunity of comparing the period with which his two volumes deal with the present. From one point of view the contrast is extraordinary. Till recently we were accustomed to think of Great Britain and Ireland as having made a prodigious effort in the struggle with revolutionary and Napoleonic France: after three years of the present war no one can read Smart's account of his first fifteen years without deriving the impression that in comparison they were a period of halcyon calm, in which not only the gentlemen of England, but the working men, and the women, gentle and simple, "lived at home at ease." Instead of our shortage of labour in every direction the complaint was of want of employment. The explanation is of course to be found not only in the much smaller proportion of

the population then engaged in the army and navy, but also, and much more largely, in the comparatively trivial proportion engaged in supplying munitions. The enormously greater intensity of our own effort may be roughly measured by the fact that we shall probably have spent in four years of war as large a proportion of our means as our ancestors did in twenty-one. In many other respects the two periods have a close resemblance: human nature is not always the same, but it does not change very much in a long-settled country in the course of a single century. In 1800—

> "The Committee on the High Price of Provisions issued report after report. Bread riots now began in many parts of England and Scotland; and, in response to petitions, the King convened Parliament in November,—'out of a tender regard for the welfare of his subjects and a sense of the difficulties with which the poorer classes, particularly, had to struggle.' In the debates on the Speech, the high prices were ascribed variously to the bad seasons, to the war, to the incompetency of the Ministers, to the heavy taxation, to the over-issue of bank paper. Outside of Parliament the blame was thrown very generally on the 'middleman.' The Earl of Warwick appealed to the Bishops 'whether there was any passage in Holy Writ which sanctioned the business of a corn factor.' The ascription of high prices to the speculation of merchants, indeed, still had a strong hold, even among educated people. . . . The magistrates in many places gave notice by public advertisement that all persons guilty of forestalling, regrating, or engrossing provisions were punishable by indictment, and would be proceeded against with the utmost severity. . . . Mr. Rusby was tried . . . for having purchased 90 qrs. of oats at 41*s*. per qr. and sold 30 of them again in the same market on the same day at 44*s*."

How ineffably silly all this seemed to Smart and the readers of his first volume in 1910, and how eminently right and proper it looks to most of us in the autumn of 1917!

The prevailing attitude of mind towards agriculture, too, is strictly parallel. In both periods the country is driven by the war to think of national self-sufficiency in regard to the food-supply as an object of the highest importance, and drops easily into the policy of aiding agriculture at the expense of other interests not only as a war-measure but permanently.

While we look at Smart's first fifteen years for parallels with our present condition, we may look at his last fifteen years for suggestions about the probable course of events after the conclu-

sion of the coming peace. We can find little to support the sanguine view (perhaps less strongly held now than two years ago) that a peace boom is to follow the war boom. The effect of the disappearance of munitions industry is suggested by the fact that in 1817 "Brougham presented a petition signed by nearly the whole of the labouring population of Birmingham—11,000 names signed in less than 48 hours—a statement, he said, in humble but impressive language of the degree of misery to which they were reduced. Many of the petitioners had not had any kind of employment for several months, and few of them had had more than two or three days' work at reduced wages." Three years later another petition demanding an inquiry into the causes of the stagnation of trade came from the manufacturers and traders of Birmingham. Protected agriculture was in a recurrent state of crisis throughout the whole period.

Nor does there seem much support for those who, again perhaps with less confidence than two years ago, imagine that the States of Europe and our own in particular will emerge from the war stronger and more popular as economic engines than when they went in. Just as after 1815, the major portion of the revenue of the United Kingdom will be collected for the benefit of the public creditors—the holders of obligations contracted during a period of great inflation. The tax-gatherer is never popular, but is most unpopular when he is collecting interest on debt, and the probability of a recurrence of "impatience of taxation" is not rendered smaller by the fact that much of the increase of taxation in the decades immediately preceding the present war meant a taking from the rich for the benefit of the poor: after the war the contrast will be striking—in spite of large numbers of persons having subscribed to war-loans, the overwhelming bulk of the aggregate will be held by the well-to-do and by institutions which the popular mind, often wrongly, regards as belonging to that class. Smart (evidently writing before the war) says under 1830:

"It should be remembered that the bulk of the taxes was then actually *felt* as a burden—a burden on the present and in times of peace. More than half the taxation went to pay the interest on the Debt, and, roughly, a third was for army and navy services. If we take the modern Budget, and notice that, over a long succession of years the burden of the debt has decreased both absolutely and

relatively, while the expenditure on Civil Services (including Education) has increased from £20 millions in 1896–7 to £52 millions in 1912–13, we may appreciate better the modern emphasis on taxation as a payment for very definite services rendered. If we add this to the point emphasized by Poulett Thomson, that the indirect taxation was not only a costly way of raising revenue, but was actually hindering the development of industry and the growth of wealth, we may understand the persistence into much later years of the statement that 'taxation is an evil'—which seems to the modern economist very much the same, and to have as much truth in it, as saying that payment for one's butcher's bill is a 'burden.'"

After the war the economist will again be less complacent, and popular feeling will move with him.

1918

I

WHY THE WAR COSTS SO MUCH

[A "Note" in the *Economic Journal* for March, 1918, on the Finance Accounts for 1916–17 and the first three *Reports of the Select Committee on National Expenditure* (No. 102, and Nos. 151, 167 and 188 of 1917).]

THE Finance Accounts appeared unusually late this year and only in time for this number of the *Journal*. A wholly laudable, but somewhat pathetic, striving for economy has led to the disappearance of some dozen blank or nearly blank pages and of the familiar blue cover. Otherwise, to a superficial view, the war has made little difference: the sum paid for the salaries of the Six Trumpeters in Edinburgh has fallen from £98 8*s*. 5*d*. before the war to £77 5*s*. 10*d*. because "the salary of one Trumpeter has been suspended for the period of his absence on military service," but "The Poor Scholars of Oxford," though the proportion of them absent is more like 5 in 6 than 1 in 6, receive as usual the £3 1*s*. 6*d*. which they have had ever since the riot on St. Sepulchre's Day in the reign of John. Some day, perhaps, after the war the Treasury may find time to eliminate unnecessary detail, and insert instead more particulars about some of the larger items.

Comparing the figures with those of the last year of peace, 1913–14, we find that the total expenses of civil government, including education, old-age pensions, health and unemployment insurance, labour exchanges, grants in aid of local taxation, and the Post Office have remained almost stationary at about £97 millions, natural increases and increases due to the war being about balanced by war economies and savings due to absences on military service. Interest on debt, including that on the "Other Capital Liabilities," was about £20 millions in 1913–14 and had

risen to about £128 millions in 1916–17, but this is the amount actually paid, while the aggregate liabilities were largely increasing. The interest payable on what was due at the end of the year must be in the neighbourhood of £190 millions. And finally, naval and military expenses were, excluding repayment of debt in military and naval votes, about £75 millions in 1913–14 and £1,971 millions in 1916–17. The corresponding figure for 1915–16 was £1,398 millions and for the eight war months of 1914–15 it may be put at £410 millions, making a total to March 31 of £3,779 millions, or, if we deduct £213 millions for naval and military expenses on the scale prevailing just before the war, £3,566 millions for the special cost of the war. The Committee on National Expenditure make it £5,000 millions up to September 30, 1917.

If we assume that the war had to begin and cannot be stopped, we may still find it interesting to inquire whether it ought to have cost so much, and possibly advantageous as well as interesting to inquire whether its cost should continue on its upward course. For this purpose the Committee on National Expenditure have been appointed, and, so far as can be seen at present, they are doing very good work and likely to be of great service. They have made a large number of useful suggestions on points of detail which, in the aggregate, may mean the saving of hundreds of millions, and they have also managed to bring out some principles neglect of which has cost our own State and the community of nations even larger sums. One of these appears in section 9 of the First Report. It is what, when once stated, seems a very obvious truth—that in the choice between different military policies their comparative cost is one of the matters which should be taken into consideration, or, in other words, if there are two ways of gaining the same end, the cheaper ought to be preferred. The Committee found that " the Imperial General Staff, who are the advisers of H.M. Government on all matters of military operations, are not instructed to consider, and do not regard it as part of their functions to consider, the money cost of any policy which they may propose."

In the Second Report they touch, though with a much less certain hand, an even more important cause of expense, the belief that the war ought to be and can be carried on without any economic loss except that of the luxuries of the wealthy. They are sure that neither the percentage of profits nor the commodi-

ties and services which can be purchased with wages should be increased in consequence of the war, but they shrink from bold assertion of the truth that the mass of the population must not expect to be as well off in war as in peace. The furthest they will go is to be found in section 33:

> "The strongest case should be required to be established before any advance of wages is conceded on any ground other than the rise in the cost of living. Nor should it be regarded as a rule—and we have no reason to think that Labour in general desires that it should—that wage-earners in receipt of not inadequate pay before the war should be exempted from all share in the economic sacrifices involved by a state of war."

They recognize in section 32 that increases of wages to meet the increased cost of living result in still further increase in cost of living and vastly increase the cost of the war, but they fail to draw the inference that wages ought not to be increased to meet the cost of living, that if they were not, the cost of living would not rise so much, and the cost of the war would be less, while at the same time the actual necessaries and comforts enjoyed by the mass of the population would have been greater than it is because the required reduction of consumption would have been effected quietly and economically in normal ways instead of by the noisy and wasteful methods of Sir Arthur Yapp, Lord Rhondda, and all the other Controllers with their gigantic staffs of flappers and incapable men. Far from attempting in a futile manner to keep the mass of the population in the same comfort as before by raising their money-wages, a State which wished to carry on a war of the present magnitude ought to have endeavoured at once to reduce their net money-means by heavy taxation. It is true that something in that way was done, but how little! The yield of Customs and Excise together only rose from £75 millions in 1913–14 to £127 millions in 1916–17. Though *per capita* money income has increased enormously in the hundred years, and especially in the last three years, the higher figure means little more per head than was paid towards the end of the Napoleonic war. Having given too much and taken too little directly, the State might still indirectly have got back some considerable amount of what it had squandered, by allowing the people to pay high prices and taking the profits resulting from them. But no! Instead of that it sells cheap when it has got

the whole supply of an article in its own hands, and cuts off the yield of the excess profits tax by enforcing maximum prices upon other sellers. And the results are the queue, equal rations, and the most dangerous discontent among a people which has plenty of money but cannot buy anything except drapery.

Some complain of a " vicious circle " and say they cannot see where to break it. Expenditure rises because prices rise, and prices rise because expenditure rises. But the simile of the kitten chasing its tail is far more appropriate. If the kitten will go slower the tail will go slower. The seat of volition is in the Government. The Chairman of the Committee complained in the House of Commons on January 30 that in the half-year since it was appointed, while its recommendations for economy in detail had been largely adopted, increases of expenditure adding nothing whatever to the goods and services obtained by the Government had been sanctioned to the extent of £196 millions per annum—just about the whole expenditure of the State before the war.

	£
The subsidy given to reduce the price of bread	45,000,000
Subsidy given to growers of potatoes	5,000,000
Further bonus given to bakers to encourage them to use potatoes in the baking of bread	150,000
Increase in the payment of soldiers and sailors	65,000,000
Additional sums paid in increased pay to officers of the Army and Navy	7,350,000
Bonus or wage advance to miners	20,000,000
Bonus or wage advance to munition workers, direct and indirect	40,000,000
Ditto, railway workers	10,000,000
Ditto, Civil Servants	3,000,000
Ditto, teachers in Ireland	170,000
Ditto, Irish Police	100,000
Additional grant to the National Insurance Fund	400,000
Total increase	£196,170,000

Faced by such profligacy, we call to mind the truest of all proverbs : " Light come, light go." Government can spend sums nine times as large as its pre-war expenditure and more than equal to the pre-war total income of all its subjects because it is able to get the money by other means than taxation. If confined to taxation, it would be prevented from raising so much by the

unpopularity of additional imposts: spending less, it would still be able to get just as much as at present owing to the lower level of wages and prices within the country, and the people would be somewhat better off.

The contribution made by taxation to the cost of the war shown by the accounts before us is considerable in proportion to the pre-war taxation, but trifling in comparison with the total expenditure. Customs and Excise, as already mentioned, rose from £75 millions before the war to £127 millions in 1916–17, income-tax and super-tax from £47 millions to £205 millions, and the excess profits tax yielded £140 millions, a total increase of £350 millions, the other branches of taxation remaining nearly the same. Increase of taxation thus provided only about one-sixth of the increase of expenditure. Though the yield will be larger during the present year, there is little prospect of the proportion rising much above one-sixth. The rest of the increase of expenditure was provided for by increase of debt as shown in the following table:—

"NATIONAL" or "DEADWEIGHT DEBT," 1914–17

(million £ at March 31)

	1914.	1915.	1916.	1917.
Funded debt, including terminable annuities	616	611	345	342
3½ per cent. War Stock and Bonds 1925–8	—	349	63	63
4½ ,, ,, ,, 1925–45	—	—	900	20
5 ,, ,, ,, 1929–47	—	—	—	2,067
4 per cent. tax compounded 1929–42	—	—	—	52
5 per cent. American loan, 1920	—	—	51	51
War expenditure certificates (2 years)	—	—	—	24
War Savings Certificates (5 years)	—	—	1	74
Exchequer Bonds 2¾ and 3 per cent. 1915	20	17	—	—
,, ,, 3 per cent. 1920	—	50	22	22
,, ,, 5 per cent. 1919, '20, '21	—	—	155	157
,, ,, 6 per cent. 1920	—	—	—	142
Treasury Bills	13	77	567	464
Temporary Advances	—	—	20	218
Other debt	—	—	9	317
Total	650	1,105	2,133	4,011
Increase in the year		455	1,028	1,878

Unlike the increase of debt during the previous "Great War," which greatly exceeded the amount of money borrowed, the

increase shown here does not differ much from the sums actually received, as the diminution in the capital of the debt involved in the conversion of Consols into War Loan has to be set against the discounts and expenses of the new issues. The total includes the amount obtained by the issue of currency notes in excess of the £28½ millions of gold held against them, as this excess is "invested" in taking up one or other of the securities named in it.

The amount, at first sight, seems astonishing and incredible if we place any reliance on pre-war estimates of national income as something probably under £2,400 millions and national savings as something probably under £400 millions. Individuals certainly are not saving all their incomes beyond what is exacted in taxation and lending them to Government! But astonishment and incredulity diminish when we reflect that money comes out from the Exchequer as fast as it goes in, and even, owing to the weekly issue of about a million of fresh currency notes, a little faster. The profusion of Government allows its subjects to lend it more money—the growing profusion of Government allows its subjects to lend it larger and larger amounts. If the Government, recognizing the national importance of the production of sound economic opinion, will provide a subsidy of £50 for each article in the *Economic Journal*, the present writer, at any rate, will be ready to invest £50 in War Bonds—nay, he will, to save trouble, accept payment in War Bonds. Writers on public finance have fumbled over the "limits to public expenditure," the prices of commodities and services being taken as fixed, or the effects of change being eliminated by discussing percentages of income. The power of Governments to obtain human energy for the purpose of fighting the enemy is certainly limited, but the limitation is based, not on the impossibility of getting more money, but on the limitation of the quantity of energy available. Provided the money is paid out, it can be raked in again. It could be raked in again (the excess profits duty furnishes an easy example) by taxation as well as by borrowing except for the fact that the human mind appreciates the futility of the business better when £100 collected by the State means immediately £100 paid by the subjects in taxes than when £100 received means £100 immediately paid away for the prospect of receiving £5 (less income-tax) per annum, while at the same time paying in the

future enough additional taxes to pay that income *plus* expenses of management of debt and the cost, direct and indirect, of collecting the new taxes.

The possibility of paying out and raking in indefinitely large sums seems to be bound up with the co-existence of a currency which can be indefinitely enlarged. A finite currency, such as that provided by a particular metal, will be found insufficient, its insufficiency will cause a want of confidence, and the want of confidence will prevent money being lent sufficiently rapidly to maintain the profuse expenditure. Hence the perpetually increasing issues of paper money even by the more solvent Governments, to whom the amounts secured by the issues themselves are comparatively unimportant. The Committee look with some suspicion on the issue of currency notes, but blunder badly in adopting the view that it would raise prices more to pay the additions to the issue out directly to contractors and other persons employed by the Government in exchange for services performed by them than to pay them to banks which give in exchange other currency which can be so paid out. What possible difference can it make whether a munitioner gets a pound-note hot from the press or cold?

II

WILL LABOUR GIVE THE GO-BY TO THE STATE?

[A review of J. A. Hobson's *Democracy after the War*, 1917, in the *Economic Journal*, for March, 1918.]

It is a little difficult to deal with this book while paying due regard to an editorial hint that reviews for the *Journal* should be economical rather than political. The present time, more than any other, is marked by a subordination of the economic to the political: have not the nations made up their minds to fight not only to the last man, but to the last shilling, franc, crown, or mark (and those all paper ones), not for their material welfare, but for something else, which, whatever it be, is certainly a political object? And Mr. Hobson is always political, so political that in this book he must even maintain that a doctrine which we are accustomed to regard as, if anything, ultra-academical, the marginal theory of value, is a "new support for the old

capitalist positions " which has been " quite recently "—most of us would say " nearly fifty years ago "—" invented and foisted into intellectual circulation."

But under the pressure of widespread starvation the world is certain to return from politics to economics, and we may speculate —we can scarcely do more—about the changes in economic organization likely to have been brought about by the war. Mr. Hobson, as might be expected from the consistency of his career, stands by the old lights of State Socialism. He admits that " the State," by which, I think, he means States in general, not the British State alone, will come out of the war considerably discredited by military and economic failures, and he is alive to the importance of the " disposition in some labour quarters to give the go-by to the State," but he regards this disposition as " indefensible." " The vision," he says, " of a working-class organization building up for itself an economic State, governed by the workers and for the workers, within the political State, but virtually independent of that State, for the regulation of economic life, is a dangerous phantasy." And again: " The notion of two States, one a federation of trades and guilds running the whole body of economic arrangements for the nation by representative committees based upon common interests of industry, the other a political State running the services related to internal and external order, and only concerned to intervene in economic affairs at a few reserved points of contact, will not bear criticism." Perhaps not, but why must we assume that " the nation " must be the unit within which the reformed industrial organization must be confined ? In the last chapter of the book Mr. Hobson declares strongly in favour of internationalism as against the " close State," but his internationalism means relations between national units rather than anything in the nature of obliteration of the dividing lines between these units. This is a striking example of the persistence of nationalism in economics. For if the possibility of war between " nations " is eliminated, there is little reason why labour organizations, as well as capital organizations, should not overlap national boundaries. Within living memory there has been a considerable enlargement of the areas over which labour organizations spread; they already " give the go-by " to most " local authorities," including the authorities of " States " in federations. It seems shortsighted to

suppose that labour organization may not be at some future time as capable of giving the go-by to the Governments of the United States and Canada as it is now to the States of New York and Massachusetts or the municipalities of Manchester and Liverpool. Is feudalism, in the sense of a connection between the individual and definite parcels of land, to endure for ever? At one time it was necessary for the people of a village to carry on their agriculture in common; now it is convenient for the people of a town to have a common waterworks and sometimes a common tramway. There must always be a good deal of economic activity based on local divisions, and the divisions adopted in our age for fighting purposes may often continue to be accepted in a more peaceful one for the management of railways and such-like, just as the ancient kingdom of Kent survives for the management of main roads at present. But that these territories, or any territories, must be the basis of the kind of future economic organization after which socialists vaguely aspire seems a rash proposition to lay down. In the chapter on "Militarism and Capitalism" Mr. Hobson enlarges on the manner in which capitalist syndicalism had before the war spread itself over the world, so that different States armed themselves for the approaching conflict by buying from practically the same body. May not the labour organizations of the future be equally widespread, and, for better or worse, equally powerful?

III

LABOUR VERSUS CAPITAL, OR DEBTOR VERSUS CREDITOR?

[A review in the *Economic Journal* for September, 1918, of *Labour after the War*, by various writers, edited by Sydney J. Chapman, 1918.]

YET another "after-the-war" book! Philanthropy, like every other interest, including religion, is profiteering—trying to grab what it can during the war and resolved to hold as much as possible of what it has grabbed after the war is over. The writers of the present book are like all the rest: each of them finds his former opinions greatly confirmed by the experience of the war, and has a cheerful belief that whatever evil legacies the war may leave in other directions, it will do good in promoting or even

enforcing the adoption of his own particular views of what ought to be done. The Bishop of Birmingham thinks " England had got somewhat out of hand before the war. She is now, on the whole, living in accordance with the requirements of a wholesome life, in which each "—with a ration book ?—" tries to secure what is necessary, not only for himself, but for others. This must continue." Mr. Clynes says: " All the principal functions of trade organizations must be retained to them. Neither in importance, in service, nor in freedom to act, must Trade Union authority be diminished." Lord Leverhulme believes that " The worst motive a human being can be actuated by, even from his own mere selfish point of view, is selfishness, whilst one of the highest motives, and certainly a heaven-inspired motive, is that of enlightened self-interest. Under the elevating influence of enlightened self-interest, Capital and Labour, employer and employee, can be combined as co-partners to make efficiency and higher production a stepping-stone to greater comfort and happiness." And so on. We may wonder whether, after all, the great problem of the future will be the relations of Capital and Labour. May it not rather be the relations between Debtor and Creditor, or, rather, between those with fixed money incomes from property and those with variable incomes ? The various belligerent States have abandoned the gold standard in favour of paper standards which circumstances lead—they say compel—them to keep on depreciating by over-issue. Each of the currencies is depreciated in gold, and gold itself is greatly depreciated by its disuse as currency. The States buy commodities and services at enormously enhanced rates, and, borrowing for the purpose, bind themselves to pay annual interest in pounds, francs, marks, dollars, and the rest. General wages and prices have risen to levels corresponding with the depreciation, and many of the increases have with amazing folly been adopted in legislative enactments intended to govern the future. Will not the really great economic question be what the pounds, francs, and the rest are to be worth after the war ? The interest of the States, considered as Government machines, will be in favour of keeping down the value of these monetary units or lowering it still further, inasmuch as the predominant function of Government will be the collection of money to pay the State creditors with, and it is clearly much easier to collect any given sum in taxes if the unit in which the sum is

reckoned is of small value. Against this will be arrayed the holders of national obligations, reinforced by the whole body of other *rentiers* in the strict sense, holders of debentures, preference stock, chief rents, and such-like things which cannot possibly benefit by high prices, and by a contingent of pensioners and workers whose incomes are more or less difficult to move. Who will say with certainty what the result of the conflict will be, or whether, when the depreciators have won, they may not in the end throw away their success by over-issuing to that excess which leads to the non-acceptance of the issue and a consequent fresh start? Anyway, it is certain that there will be a period in which the value of the monetary unit will not have even the moderate amount of stability which it had before the war. This lends additional interest to the Editor's proposal for arrangements under which reconsideration of wage-rates fixed by collective bargaining or other organized methods would take place as a matter of course at definite periodical intervals, so as to avoid the friction caused when reconsideration can only occur on the demand of one party, which is consequently regarded by the other party as opening hostilities. If the standard of value is to shift about more than ever, this scheme might be useful because it would not only make the wages of each industry vary with the prosperity of that particular industry, but would also adjust wages generally to changes in the value of the monetary unit, commonly called changes in the cost of living. It would, of course, require the abandonment of the pernicious practice of endeavouring to settle wages for long periods into the future, which inevitably leads to disputes embittered by allegations of bad faith.

IV

"WE HAD BUTTER: A BENEFICENT STATE HAS GIVEN US MARGARINE"

[A review in the *Economic Journal* for December, 1918, of *The State and Industry after the War*, Papers by H. Sanderson Furniss, John Hilton, and J. J. Mallon, 1918.]

This report of a Ruskin College conference of working-class associations, held at Manchester on May 10 and 11, like its pre-

decessors, will give the future historian some little help towards discovering what the more thoughtful members of the working-class were thinking in 1918, though the discussions on the papers seem to have been scarcely so vigorous as at some of the earlier conferences.

We may note the strange persistence of the idea that private enterprise is to be blamed for being discovered unequal to the task of carrying on the war. Before the war did anyone ever suppose that it was the business of private enterprise to carry on war? The business of private enterprise was to provide people with the things they were prepared to pay for under a *régime* of peace and order maintained by the various civilized States. Suddenly, in August, 1914, several of these States deserted their *rôle* of preserving peace and order and began instead to kill each other's subjects, to steal each other's subjects' property so far as they could, and to destroy what they could not carry away. And then, when private enterprise found itself somewhat incommoded by these proceedings, it is said to have "broken down" and the various States are said to have "come to the rescue" with their moratoriums and their floods of paper money with which they doubled prices while pretending to protect their subjects from the greedy profiteer. Verily, a precious kind of rescue!

Mr. Furniss on "The State and the Citizen" is not impeccable on this matter, but Mr. J. J. Mallon on "The State and the Consumer" is a much more determined advocate of the theory that the State has shown great industrial capacity. To illustrate "the creative work" of the Ministry of Food, he says:—

> "In 1913 the consumption of butter in the United Kingdom was 16½ lb. per head per annum, and of margarine 4½ lb. per head; that is, the consumption of butter was nearly four times that of margarine. To-day the weekly output of home-produced margarine is three times what it was in 1913, while imported margarine in January stood nearly at the 1913 level. The import vital a few months ago is no longer essential. In a few weeks the United Kingdom will have become self-supporting in margarine production."

Mr. Mallon may live to contribute to the epitaph of the semi-feudal State which tried to become industrial in its old age, and his contribution will be: "Its subjects had butter, and it gave them margarine instead." Mr. John Hilton on "The State

and the Producer" is a good corrective to Mr. Mallon. In its control of shipping, he remarks with pungent humour (p. 56), "the Government appeased the very natural indignation of the public at the expense of the public's stomach." He reminds his hearers that while the hurry of the period has certainly been inimical to success, the State has been enormously assisted by the patriotic fervour engendered by the war, and by the fact that it took over going concerns—"there is a momentum about a going concern which will carry it a long way, even though the initial energy be cut off, as has often been seen when the able founder of a business has died and left his fool son to carry on." He might have added that the reckless borrowing and emission of paper money carried out by all the belligerents gives both the lenders of the money and the receivers of the bonuses and subsidies paid out of it a delusive feeling of prosperity, but cannot continue indefinitely. The State has certainly done greater things than anyone expected: no one before the war ever thought the British Government would *borrow* annually a sum equal to the whole pre-war yield of the income-tax in order to pay a part of the cost of the people's bread. Glorious achievement! "Men," says Mr. Mallon, "no longer gamble or speculate in wheat, or, in the old sense, no longer make profit out of it." How to reconcile his belief in the Government's success in buying and in preventing inordinate profits everywhere with the fact that about two thousand millions can be subscribed to war loans in a year, he does not explain. The only tolerably acceptable explanation yet suggested is that the Government departments shovel out money so liberally that some people are receiving amounts enormously greater than they received before the war. Mr. Mallon's economical State pays them too much, borrows back much of what it has paid them,—and each year saddles the taxpayers with another hundred millions a year of interest in perpetuity.

V

SHOULD NATIONAL DEBTS BE ENFORCED?

[At the end of August, 1918, when the end of the War seemed still some way off, the Research Committee of the League of Free Nations Association asked me to join a sub-committee on "Problems mainly Economic." I

consented, and the sub-committee used to meet from October onwards in my room in the temporary building which then stood at the back of the School of Economics in Clare Market. I acted as Chairman, but William Archer, who was Secretary of the Research Committee, our parent body, was the moving spirit. Members of the sub-committee prepared memoranda on the reorganization of the world which was to take place after the War, and according to the scheme of the Research Committee these should have been licked into reports of the sub-committee, and, after separate publication, eventually co-ordinated with reports of other sub-committees "in a General Report on the whole question of a League of Nations, which might serve as a basis for discussion in an eventual International Conference." I always felt that we might be likened to the three tailors of Tooley Street, and, in fact, the sub-committee somehow faded away in March, without leaving any trace of influence on the course of history.

But I think it worth while to save my memorandum from oblivion because its underlying idea that it would be a good thing for the world at large if the contraction of debt by sovereign governments were drastically checked seems to be a sound one and deserving of serious consideration. The thoughtless manner in which the subject is treated in most financial circles may be illustrated by the remark which a banker made to me some time before the war. I had suggested that sooner or later Russia would default, and his reply was, "She can't do that, because she will always want to borrow more." To-day we see complete readiness to lend again to defaulting governments if they will only "acknowledge" their old debts and promise to pay perhaps 2*s*. in the £ of what is due on them—and that out of the new money to be lent to them. Hamburg, issuing a new loan in 1926, actually attracted investors by assuring them that her obligations to previous lenders had been nearly wiped off the slate by the depreciation of the old mark!]

December 2, 1918.

UNDER the old system of unrestricted sovereignty each State could, of course, repudiate its debts quite legally. It could make what laws it pleased about their payment or non-payment, and could be summoned before no outside Court. The greater Powers were able to borrow both from domestic and foreign lenders not because there was any authority or other outside force which could be relied upon to compel performance of the contract, but because the lenders believed that the moral and financial discredit of repudiation was sufficient to prevent refusal to pay. The French investors in Russian bonds, for example, advanced their money to Russia because they thought Russia would always be able and willing to pay: they never contemplated the possibility of some European or Mundane Court having to listen to

their plaint and put bailiffs into Russia; they did not even contemplate the possibility of getting their own Government to make war upon Russia if Russia refused to pay: Russia promised and they relied upon that promise.

But the case of loans to some of the smaller and weaker States was not quite the same. While there was no authority which could compel States to pay their debts, on the other hand there was no law preventing other States from exercising force against them if they refused to pay, and in fact lending to some of these smaller States was perhaps encouraged by the investors' hope that in the last resort some group of Great Powers whose subjects had lent large amounts would oppose default by force.

Turkey, Egypt, and Venezuela are generally given as examples of debtor States forced by Great Powers to pay their foreign creditors. The outside interference was no doubt sometimes mixed up with interference for other reasons from which it is difficult to disentangle it, but there seems no reason to doubt that many statesmen of the Great Powers regarded the collection of debt from foreign States as one of the duties of every great and self-respecting country, though they were not prepared to attempt to perform it where the debtor or his friends were too strong to make it worth while.

In December, 1902, Dr. Luis Drago, the Foreign Minister of the Argentine Republic, alarmed at the duress which was at that time being applied to Venezuela, addressed a note to the Argentine Minister in Washington putting forward a proposition which, when stripped of an accidental connection with the Monroe doctrine, is simply that international law should not allow the use of force by any Power for the recovery of debt due in respect of public loans. Many international lawyers seem to have been willing to accept this "Drago Doctrine," and an attempt was made to embody it in the decisions of the Second Hague Conference in 1907. The resolution arrived at, however, instead of adopting the doctrine, really sanctions the use of force, by providing that it shall not be applied unless the debtor refuses to submit to arbitration.

"The contracting parties agree not to have recourse to armed force for the recovery of contract debts claimed from the government of one country by the government of another country as being due to its nationals. This undertaking is, however, not applicable when

the debtor State refuses or neglects to reply to an offer of arbitration, or, after accepting the offer renders the settlement of the *compromise* impossible, or after the arbitration fails to submit to the award."

It seems to have been supposed that the arbitrators would not merely have to settle the question (about which there would not in all probability be any dispute) whether the State had made default or not, but would have to decide whether the State was reasonably able to pay at once the whole sum due, and how much or how soon it was to pay if not. But no arbitration could be expected to decide that the foreign bondholder should never be paid anything, so that the Hague decision practically sanctioned forcible collection of debt. Belgium, Sweden, Switzerland, Roumania, and Luxemburg in Europe, China and Siam in Asia, and Brazil, Nicaragua and Venezuela in America abstained from signing the agreement, and Argentina, Guatemala, Salvador, Bolivia, Columbia, Ecuador, Peru and Uruguay only signed it with reservations which take the sting out of it.

Such being the heritage into which the League of Nations will come, the question arises whether the fulfilment of contracts with regard to national debts is to be treated as a thing to be enforced by the League. I think it will be convenient to divide the question into two, and to ask first whether new debts, i.e., national debts contracted after the League has been established, are to be regarded as enforceable by the League, and secondly whether old debts contracted before its establishment are to be so.

§ 1. *New Debts.*

The first thing to be noticed is that it would be clearly impolitic for the League to enforce the claims of foreign bondholders while ignoring those of domestic bondholders, since this course, when the League was once firmly established, would induce investors to lend to foreign Governments in preference to their own. Public opinion would, quite rightly, I think, condemn a policy of wholesale encouragement of external as compared with internal debt, and supposing this policy were adopted, the external debts would be so much larger in proportion to the internal that their enforcement would not seem so much more easy than the enforcement of all national debt as it does to us at present.

At the first glance it certainly seems as if we should rather

expect the League to enforce national debts. These States which borrow ought to fulfil their contracts with the lenders, and if they refuse, why should not the League compel them, just as a national State compels private borrowers among its subjects to fulfil their contracts? But on reflexion, this analogy is by no means convincing. The League will not be a national State, but a union of national States which voluntarily endow it with certain powers, of which the power to enforce the payment of debt need not be one. It is quite common for Federations not to have the power of compelling its constituent States to pay their debts. If Australia defaulted, does anyone imagine that an Englishman or a Canadian holding Australian bonds could, after dragging the Commonwealth before the Judicial Committee, and obtaining a decision in his favour, secure execution of the judgment by the naval and military forces of the Empire, if the Commonwealth still failed to pay? The United States Constitution, as amended in 1793, certainly prevents the Supreme Court from entertaining an action against one of the States by citizens of another State or by citizens or subjects of any foreign State (Am. XI), and several States constituting the United States have as a matter of fact defaulted, and redress has never been obtained by their creditors. Moreover, no State adopts the policy of indiscriminate enforcement of every kind of contract on every occasion. An insolvent debtor is no longer handed over as a slave to his creditor: particular kinds and amounts of property are often exempt from distraint; gambling debts are generally irrecoverable at law; the liability of shareholders in companies is generally limited. The fact is that States pick and choose between contracts, enforcing only those which they regard it as expedient to enforce. If the enforcement of contracts is the general rule, that is only because contracts are mostly of the kind which it is expedient to enforce, not because there is any moral obligation on the State to enforce all contracts, and, when the matter is examined closely, it seems quite clear that it would be highly inexpedient for the League of Nations to hold itself out as an authority which in the last resort would use force (whether of a military or economic character) against one of the constituent States which failed to pay its debts.

Under an effective League, of course, national borrowing would no longer take place for aggressive war, but we cannot shut our eyes to the fact that it is highly probable that some of the demo-

cratic Governments of the future may be exceedingly feather-brained and desirous of borrowing enormous amounts for other purposes which may prove in the end to be anything but remunerative. If it is understood that the whole force of the League stands behind the lender to such Governments, these Governments will be able to raise far more money for such purposes than they otherwise could. The lender will need only to look at the security, which, so far as the League is really effective, will then be the whole material property and goodwill of the country in question, and he need give no attention to the purpose of the loan or the capacity of the Government to carry out the purpose in view. If, on the other hand, the League takes no more responsibility for the loan than the United States accepts for debts of its constituent States or than the British Treasury accepts for debts of the Dominions and Colonies, the maxim, *caveat creditor*, will come into play, and secure that sober and practical Governments will be able to borrow for profitable and desirable objects, while crack-brained enthusiasts will have to resort to immediate taxation with all its cooling influence, or to desist altogether from their mad schemes. This argument is much strengthened when we remind ourselves that national debts in any comprehensive use of the term include Government paper money. Does anyone seriously propose that the League should enforce the claims of holders of such money to be paid its full nominal value in the metal it was originally supposed to represent? Even as things are, some Swedes and Swiss are said to purchase Petrograd rouble notes, and therefore indirectly to lend to and support the Bolshevik Government, not because they believe in that Government, but because they expect outside interference to insist on its liabilities being treated as a mortgage on the resources of the whole Russian territory. How much worse would it be if this was a certainty, as it would be under an effective League of Nations which had adopted the principle that it would see to the carrying out of the promises of any *de facto* Government, however dishonest, crazy, and ephemeral, up to the full value of the whole material property of the country and anything more that could be wrung from such of its inhabitants as were unable or unwilling to leave it for happier lands!

Some one will perhaps suggest that it would be possible for the League to exercise a control over borrowing—and perhaps over

the issue of paper money—like that exercised by the British Government over borrowing by counties and municipalities. This may conceivably be the case in some remote future, but in the near future it is quite impracticable, and wholly undesirable: each country must be allowed to develop itself in its own way and it would never do for the League to send inspectors to the different countries to inquire whether they should be permitted to borrow for the construction of a railway or canal, after the manner of the English Local Government Board in its control of local finance.

It seems therefore inevitable that the League should adopt the Drago doctrine, not in the emasculated form accepted by the Hague Conference, but in all its fullness, and should occupy the same place in relation to its constituent parts that the United States occupies in relation to the forty States of which it is composed, declining to use force itself, and declining to allow any nation to use force for the recovery of national debts contracted after its establishment.

§ 2. *Old Debts.*

The position of the creditors of most of the belligerents in the Great War is somewhat precarious. Their readiness to lend, or at any rate to take paper money in exchange for goods and services, made it possible for the Governments to pay out sums of money which every one would have regarded as quite incredible down to July, 1914, and this exaggerated money-expenditure caused an inflation of prices which more than doubled the money-cost of the war. If the States both pay what they have promised to pay and bring back their depreciated currency to its pre-war standard, the pressure on the tax system will everywhere be exceedingly severe, and it is highly probable that the national bondholder will be unpopular in rather wide circles. This is the kind of reflection that occurs to anyone who thinks of the situation in the victorious countries which will maintain or even increase their territories and which pay no indemnities, and it sufficiently suggests that it would be extremely impolitic for the League to take any responsibility for the existing debts or all or any of them. If any of the countries defaulted entirely or in part, either openly or by some tortuous currency method, the League would be unable to compel payment, and in all probability any attempt to do so would bring about its dissolution.

But this is the most favourable side of the national debt position. What of the debts of the other countries, riven by internal revolutions and almost unrecognizable owing to rearrangements of territory?

A simple transference of a small portion of territory from one defeated country to another victorious one, as, for example, Alsace-Lorraine from Germany to France, presents little difficulty. We may take it that the transferred territory will not carry with it any portion of the debt of the country from which it is detached. Precedents seem to be overwhelmingly against any such transference of general debt, and could scarcely be otherwise where the Power gaining an acquisition of territory has been a conqueror, or, as in the case of Alaska and the Danish West Indian Islands, a purchaser. It would be unlikely that an agreement to take over part of the debt would be embodied in the treaty.

Local debt, however, and even national debt incurred for public works within the territory, has commonly been taken over. Considerable difficulty may arise in distinguishing between local and general debt when (as in the case of Alsace-Lorraine) part of the cost of the war has been met by local loans, but this is a detail.

The position of the losing country is so far rendered more difficult, and that of the gaining country more favourable, but this may be taken into account in the settlement as a whole.

Cases of more complete rearrangement of territory present much more difficulty. When new countries, inhabited by what have hitherto been subject nationalities, are carved out of the previous territories, will these new countries, often extremely impecunious, be expected to take over a part of the debt of the autocracies which formerly oppressed them, and borrowed in order to keep them oppressed and to carry on war with their friends outside? This seems to me both unjust and practically impossible. A restored Poland, for example, could not justly be expected to shoulder a share (calculated, I suppose, in proportion to wealth) of the war debts of Germany, Austria-Hungary, and Russia, and if such share were put upon it, we may be fairly certain that it would not be long before inability to pay was pleaded, and the world-authority involved in the unpopular and probably impossible task of debt collecting from a hostile population. On

the other hand, to concentrate the whole existing debt on the territory left to the old States in such case will probably be sometimes as impracticable, and little, if at all, more just. It may be impracticable, because the territory so left may be too small to bear the whole burden, or indeed, may be non-existent, the old State having entirely disappeared: and it may be unjust because the inhabitants and proprietors of the remaining territory or some of it, may be as little morally responsible for the war and the debt as those of the detached territories—a Turcoman in Khiva can scarcely be regarded as more responsible than a Pole in Warsaw for the debt contracted by the Tsar's Government or for the rouble notes issued by the Bolsheviks.

The conclusion to which all this points is that the Peace Conference will very probably find it desirable to let the dead bury their dead so far as the national debts and paper currencies of some of the old countries are concerned: their apportionment among the new countries and the remains, if any, of the old, will appear too impracticable. The Allies have already made a beginning by their scheme for a sixpenny gold-exchange rouble which suggests at once the abandonment of the vast mass of Tsarist and Bolshevik paper roubles and the eventual adoption of a much lower standard for the rouble than that existing at the beginning of the war, and a consequent virtual composition in regard to rouble loans. For my part, though I know some members of the Sub-Committee disagree, I see no great harm in the fact that lenders to bellicose and corrupt Governments will lose their money: it will be a lesson to investors which will be useful in securing peace and good government in the future. The lesson will be all the more effective if loans made specifically for and actually applied to some productive purpose are saved from the general wreck, and as such loans will have left public works of some kind in some territory or other there should be little difficulty about allocating the obligation to pay them.

But whatever the actual peace settlement may be, there can be little doubt that in the establishment of the League extreme care should be taken to prevent the League being made responsible for the carrying out of a Treaty or Treaties which require large payments to be made (either capital or interest) from one Government to another or from the taxpayers in one country to bondholders in another. A league which attempts to keep one set of

countries against their will tributary to another set will not be a League of Peace but a League for the Maintenance of Discord. Such payments from one country to another as are the necessary results of the war should be completely made during the transition period or at least arranged for in some way which will secure that the League of Nations shall not be obliged by decisions of its own Law Court to enforce them whether it is expedient to do so or not.

1919

I

"THE WAR HAS MADE MANY A HAPPY HOME"

[A review article in the *Economic Journal* for June, 1919, of Bowley's *Division of the Product of Industry: An Analysis of National Income before the War*, 1919. The story of the charwoman's remark was told me by an economic historian as a true one. It typifies the feelings of many who found themselves better off during the war than ever before—especially of wives who had good-for-nothing husbands conscripted for military service and became entitled to allowances for themselves and their children.]

No reader of the *Journal* with any serious interest in the distribution of income is likely not to have read Professor Bowley's masterly contribution to the subject by this time, so that I need not waste space in summarizing his conclusions, which appear to be eminently sound, though they have excited some indignation in minds of undue optimism which find the atmosphere under his wet blanket somewhat suffocating.

It seems more useful to attempt to pave the way, or at least to throw down some road-making material, for a consideration of the amount and distribution of the product of industry during the war. Unless statisticians and economists will give some time and energy to this subject, it seems probable that during the years of lassitude and painful recovery following the war the question will often be asked and left unanswered, "Why were we so much better off during the war?" Continued failure to answer will involve great dangers. The bourgeois economist, intent on winning the war, laughed when his charwoman said: "This war has made many a happy home." Will he laugh when the charwoman's son, experienced in the art of fighting and hardened by familiarity with its horrors, says: "When I was in the trenches you gave me my pay and lots of

bully-beef, and you gave mother an allowance: if you could do it then, you can do it now, so why should I work? Didn't Lloyd George promise me a happier England?" The question is not part of Professor Bowley's subject, and he does not deal with it except incidentally in a couple of sentences on page 54:—

"The large income and lavish expenditure of 1918 were mainly due to the great inflation of prices, and partly due to borrowing from abroad and calling in capital. No one can reckon what the product of 1918 would have been worth at pre-war prices; the unit of value is unstable and unknown."

"The large income" is, of course, the large sum of money at which the aggregate incomes of all the inhabitants of, or, more strictly, all the persons resident in, the country are valued. Did this sum, which was, I suppose, between 50 and 100 per cent. more than the corresponding sum for 1913, represent a "product of industry" increased by as large a percentage? That Professor Bowley does not think so is implied by his saying that the largeness of the sum of money "was mainly due to the inflation of prices," and all reasonable persons will agree with him. But this seems to indicate that though "no one can reckon what the product of 1918 would have been worth at pre-war prices," yet we believe ourselves capable of comparing the magnitude of the product of 1918 with that of 1913, to this extent at any rate, that we are prepared to say that the product of 1918 was not as much greater than that of 1913 as the (money valuation) income of 1918 was greater than that of 1913. How do we measure? Not by applying index numbers of prices in 1913 and 1918 to the money valuation of income for the two years, because many people know nothing about index numbers of prices, and those who do would feel it hopeless to apply them, having regard to the enormous difference in the qualities and in the kinds of the articles constituting "the product." It is bad enough to find tough or over-salted bacon instead of the old article, and margarine for butter, but worse when "tanks" are substituted for touring cars and aeroplane bombs for whisky. Confusion is rendered worse confounded when a particularly dangerous form of labour ceases to be bought from free men at the price it will fetch, but is obtained by compelling a large section of the people to serve at rates which would not, in fact, have tempted them.

The differences are of the same kind as those which would prevent us from using the method of index numbers for comparing the magnitude of the product in the reign of William the Conqueror with that of 1900, even if we had the requisite prices. The fact seems to be that when prices and aggregate prices fail us, we form our estimates of magnitude of product from our knowledge of the amount of effort put forth and the various conditions regulating the productiveness of effort prevailing at the time. No one supposes that the product of industry of the Australian aborigines was large: asked why we believe it to have been small, most of us would be content to answer something to the effect that we know that their numbers were small, their industry not great, and their knowledge and instruments of a very low order, "so that they could not have produced much." The same answer would be given about the product of the people of this country in the time of William I, and we must follow the same line of thought in comparing 1918 with 1913.

About the aggregate of labour performed in this country, including that of the army abroad and of the sailors afloat, there is no doubt. The aggregate number of persons at work increased considerably, and of those who worked, some worked both harder and longer, some perhaps not quite so hard, but sufficiently longer to more than counterbalance the reduction of intensity of labour during the time worked. So we should expect an increase of product, if we had to think only of the amount of labour. But its productiveness also has to be taken into account. Did a given amount of labour effort produce more or less? First let us consider labour employed in producing the things ordinarily required for peaceful purposes. Here we may admit a certain gain arising from greater willingness and agility of mind among the workers who continued in ordinary industry, and also a certain gain arising from "increasing returns" in certain industries when the labour employed was simply reduced. We may be sure, for example, that a reduction of labour employed on a farm from ten to eight generally reduced the product by less than 20 per cent., even without any increase of personal efficiency, so that the productiveness of the eight men's labour was increased. On the other hand, the substituted labour was generally much worse than the old; that of the women and boys was constantly inferior from want of muscular power, and that

of old or unfit men who emerged from retirement or from idleness and professional unemployment was for the most part contemptible. Moreover, organization was thrown into confusion by the war owing to interruption of communications with the outside world and all sorts of Government demands for men and things, besides interminable well-meant but hampering regulations. On the whole it seems likely that the productiveness of industry in procuring things of ordinary peace consumption diminished.

Secondly, we have to think of the war products. In this province no one can fail to recognize an enormous increase in the productiveness of labour if we measure it by quantity and quality of articles, such as shells and aeroplanes, and of services such as firing shells at given targets and curing wounds. And we must reckon it in that way. The labour did produce what it was immediately intended to produce, though the war itself was not productive, but destructive ; if the war could have been avoided altogether by the exercise of common sense, that no more disproves the greater productivity of labour in making shells than the fact that rabies need not have been introduced into the country would disprove greater productivity in making dog muzzles.

The proportion of the aggregate labour employed in producing war products and the increase of productiveness in this province were both so large that we can scarcely avoid the conclusion that they must have outweighed the loss of productiveness in regard to peace products, so that in regard to all kinds of products taken together productiveness increased.

But if both the labour and the productiveness of labour increased, we cannot fail to admit that the product of 1918 must have been greater than that of 1913, so that the rise of (money valuation) income in 1918 does to some extent at least represent an increase of " real income " in the sense in which that term is most commonly understood.

It is very pleasant to have an addition of £50 to your income, but if the year in which the addition takes place happens unfortunately to be one in which you have to pay doctors and a nursing home £200, you are not better but worse off than in the year before. So in the Great War, though the product and " real income " increased, the world in general was worse off. The

product was so largely of a non-enjoyable and even destructive kind. Instead of making things and doing things which gave comfort and pleasure to each other, people made things and did things as unpleasant as possible to their neighbours, and the increase was in these things.

That small sections of people should have been better off in spite of the general loss is not surprising. We are not even surprised if we find that on the whole the gain has been greater than the loss in some of the States which remained neutral for the whole or most of the time. But it is certainly surprising to find that a very large section of the people of one of the principal belligerent countries, the "working classes" of the United Kingdom, should be generally believed to have had "a very good time" in an economic sense (e.g., not reckoning pain of wounds, grief for lost relatives and friends, fear of aircraft bombs, etc.). How can we explain it?

The goodness of the time is no doubt largely exaggerated by the ordinary apprehension. People are so used to regarding expenses as fixed that it is difficult for them not to think themselves better off with £2 a week than with £1, even if the £2 "goes no further" than the £1 did. Moreover, deterioration in quality is apt to be overlooked. Bread seems to be bread whatever it is made of, and when war underclothes do not keep out the cold we are apt to ascribe the fault to the weather. When a workman is suffocated in a railway carriage by the presence of fifteen others and takes double the old time on the journey, it does not strike him that he is paying the Government which takes his fare the same money for a less service If his increase of income were all taken away in taxes of which he was conscious, he would still think he was better off, since now he could pay taxes and yet live as well as before. Moreover, no one supposes the "good time" to have been universal; here and there, at any rate, working people distinctly lost.

But when all allowances are made, it seems difficult to deny that the working-classes in this country were as a whole somewhat better off than before the war. Anyone who is inclined to deny it will probably admit that they were not much worse off, which, in the circumstances, is only a little less surprising. Why, we may ask, were they not much worse off?

In the first place, in ordinary times the whole product is not,

as Adam Smith erroneously supposed, consumed. A considerable part of it is said to be "saved." Most of this part consists of material equipment in the shape of additions to the stock of houses, ships, factories, etc., within the country, and the rest of it consists of things which are sent abroad, either to form sources of income themselves or to purchase sources of income for inhabitants of this country. Now during the war addition to material equipment at home and foreign property abroad wholly ceased. The labour thus set free was made available for war-production and for the production of immediately consumable peace-goods.

Secondly, in ordinary times a very large amount of labour is employed in maintaining the existing material equipment in good condition. This could not be dispensed with altogether—we were compelled to replace fallen slates on our roofs and broken rails on our lines of railways. But every one knows that houses are in much worse condition than usual, and every one conversant with business knows that renewals, if not repairs, have been very seriously postponed in almost all branches of production, and that stocks of everything have run down enormously. The labour which would in ordinary times have been keeping up the material equipment was diverted to war-production and the production of immediately consumable peace-goods, and its diversion helps to explain why the people were still able to obtain as much as they did of those peace-goods.

Thirdly, instead of sending some of its product abroad to bring in future income, the country took the opposite course of selling the property of inhabitants abroad and borrowing money abroad in order to secure the immediate import of consumable goods. Stocks and shares in the United States and elsewhere were exchanged for immediate bread for the people, and the bacon over which we grumbled was bought with money borrowed there—that is to say, *it has not yet been paid for*.

It was chiefly the tapping of these resources that enabled the country as a whole to get through the war with so little real privation. Further relief was obtained by a temporary reduction in the production of babies: as soon as the war had got into full swing, the separation of husbands and wives brought about its natural effect, and the absence of some three-quarters of a million very young children was a substantial help.

That none of these resources could be of a permanent character is too obvious to need insisting on. The Prodigal Son's father was able to kill the fatted calf because, in the absence of the wastrel, he had gone on producing and saving; he was not a community which could only say: "My son, I regret that there is no calf; we ate the last old cow a week ago. But I have many Bradburies and War Bonds, and one match: let us at least warm our hands at a cheerful blaze."

I suppose that, in addition to thus "living on capital," the working-classes were to some extent assisted by a certain redistribution of consumption in their favour. Rationing cut down the housekeeping expenses of the well-to-do, in spite of the increased cost of food, so that they must have eaten less or economized more, and this left more for the poorer classes. They left off buying clothes, and their abstention partly explains the magnificence of the girl munitioners. They replaced no worn furniture. Their domestic servants left them to assist in the production either of war-products or of peace-goods, which would not be entirely for the well-to-do. Altogether they consumed a great deal less than before the war, and the working-classes derived benefit about the same in kind and degree as they do in ordinary times from a diversion of the income of the rich from expenditure on consumption to saving. What will be the end of it—whether the well-to-do in the future will themselves have to pay the whole of the interest on their war loans or will get some of it from the working-classes—is as yet uncertain. On the whole it seems likely that the redistribution of consumption was quite a small matter compared with the "living on capital." But I should like to see the question treated seriously in a statistical manner, if that is at all possible.

II

THE ALLEGED FAILURE OF PROFIT-MAKING

[In the *Common Cause* for September 5, 1919, Miss B. L. Hutchins had argued that the supply of the necessaries of life was "too serious a matter to be settled by considerations of profit alone. . . . Women . . . are likely to ask very seriously whether the methods now in vogue are good enough. It is notorious that in the first year of the war, even the huge

profits made by the armament firms did not ensure a sufficient supply of ammunition for the army, and the Government was forced to manufacture for itself. It is equally notorious that at any given time there is not enough milk to go round among the children of the poor, even if their mothers could afford to pay the price." I think she invited criticism by sending me a copy of the paper. I replied in the following letter, which appeared in the *Common Cause* for September 19.]

MADAM,—

I am astonished that my friend, Miss B. L. Hutchins, should repeat the hackneyed complaint against the profit-making motive in industry that it did not produce enough—that is to say, what *each belligerent government* considered enough—munitions for the war. Of course it did not; capitalists looked behind the "huge profits" of the moment, and held back from the conversion of old factories and the creation of new ones because they thought it would be more profitable in the long run to go on producing what the people really wanted, and were likely to go on wanting long after the delirious demand of the belligerent governments had ceased. But is it not obvious that this is entirely to the credit and not the discredit of the profit-making motive? What better thing could anyone say of private enterprise than that if munition making had been left to it instead of being taken up by the belligerent governments, the product of munitions would have been enormously less than it was? The war would have been less devastating, millions of lives would have been saved, and Miss Hutchins would have had much less need to be writing about the shortage of milk and other desirable commodities. If she is going to condemn capitalism because it did not provide enough munitions, she may just as well condemn free labour because it did not provide enough recruits for the armies. For my part I think it no blame to the ordinary contract of service, terminable at a day's or a week's notice, that the war would have either ended much sooner or been conducted on a much smaller scale if the soldiers of all the armies had been engaged on those terms.

When she goes on to say that it is "notorious that at any given time there *is* not enough milk to go round among the children of the poor, even if their mothers *could* afford to pay the price," she is mixing up her grammatical moods. As mothers *can* not afford to pay, there *is* not enough milk to go round;

but if mothers *could* afford to pay, there *would be* enough to go round, because it would pay to produce the larger quantity.

III

CURRENCY ON THE EVE OF THE CUNLIFFE LIMITATION

[The First Report of the Committee on Currency and Foreign Exchanges After the War, called the Cunliffe Committee after its Chairman (Cd. 9182)—was presented in August, 1918, and cannot be understood unless it is realized that at that time no wide divergence between the value of the pound sterling and its par gold equivalent was expected to appear at the end of the war. It is this fact which explains the easy allusion to "gold imports" in the passage, section 43, in which the Committee recommend that during the transitional period after demobilization, "the issue should remain a Government issue, but that such post-war expansion (if any) as may take place should be covered, not by the investment of the proceeds of the new notes in Government securities, as at present" (i.e., that money raised by the issue of additional notes should not be lent to the Government as at present), "but by taking Bank of England notes from the Bank and holding them in the Currency Note Reserve, and that as and when opportunity arises for providing cover for the existing fiduciary portion of the issue, the same procedure should be followed. The effect of this arrangement would be that the demands for new currency would operate in the normal way to reduce the reserve in the Banking Department of the Bank of England, which would have to be restored by raising money rates and encouraging gold imports."

As time wore on in 1919, it appeared clearly, in spite of the seasonal fluctuations, which were not then so well understood as they are now, that no reduction, cautious or other, was being made in the amount of Currency Notes outstanding. Nor till August was any attempt made to carry out the recommendation of the Cunliffe Committee that any additions to the amount were to be fully "covered by," i.e., only used for the purpose of being exchanged for, Bank of England notes which were to be retained in the Currency Note Reserve. But in the August Bank Holiday week, when the amount outstanding increased nearly two millions, Bank of England notes for the first time appeared, to the extent of £200,000, in the reserve along with the £28½ millions of gold which had long been there. By October 8, this amount of bank-notes had been increased by irregular instalments to £1,700,000, and the fiduciary or uncovered issue was nearly two millions less than on August 6, but this reduction was less than what would have occurred from purely seasonal causes if the general trend had not been upwards.

Hence the following letters.

§ 1. *Issue and Cover: New Fable of the Hare and the Tortoise.*

[A letter to a friend who happened to be a member of the Cunliffe Committee.]

October 11, 1919.

DEAR——

Isn't it time that your Cunliffe Committee woke up again and explained to the Treasury that when you said on page 11, "new notes should be issued not against Government securities but against Bank of England notes," you meant that *all* additional notes should be so issued and not merely one out of ten or eleven? I have been writing an Introduction to the Bullion Report, which P. S. King and Son are reprinting, and am amazed at the way in which the blunders of a century ago are being repeated with the same apologies. In the 1815–19 period the Bank tried to collect a stock of gold by buying it at 80*s*. per standard ounce with its depreciated paper and was very properly laughed at for its pains, and Parliament (save the mark!) had to intervene to prevent the poor old thing having all its hoard taken out at 77*s*. 10½*d*. when it tried its experiment in resumption. Now we have the much greater absurdity of the Treasury buying Bank of England notes with new additional Bradburies when the price of gold is 90*s*.!

So far, I observe, the Bank has managed to avoid increasing its stock of gold ever since it made the new agreement (July 24, 1919) with the South African gold mines—an agreement which is very obscure, but certainly does not appear to give the Bank any right to get gold at or near the old Mint price. If it can go on doing so [i.e., if the Bank can continue to avoid increasing its stock of gold], the Treasury will end by getting the whole Bank of England note issue into the Currency Note Reserve, and people who used to have £5 and £10 notes will have to be content with 5 and 10 separate Bradburies, which will have no effect on Bradburies except to depreciate them a little more, because they will be more inconvenient than the larger notes; eventually, I suppose, a demand might arise for £5 and £10 Currency Notes—I wonder that no one has asked for them already. But I cannot imagine the Bank submitting peaceably to such a withdrawal of its notes from circulation. What then will happen? The

Bank will never buy gold at 90*s.* out of its own pocket: will the Government buy gold at 90*s.* and hand it to the Bank at 77*s.* 10½*d.*? Supposing even it refused to make banking a subsidized industry, could not the Bank force its hands by demanding sovereigns for all the Bradburies which come into its possession from time to time, and so drawing out the 28½ millions of gold in the Currency Note Account Reserve? or the Bank of England notes [in that reserve] if the Government preferred? It looks really as if an end would soon come to this crazy policy of one in ten which suggests a new version of the Hare and the Tortoise—"The tortoise said to the hare, 'My dear fellow, you are much too fast for me, but if you will only promise not to run more than ten times as fast as I do, I may have a chance.' To which the hare very readily agreed."

§ 2. *Why should not Seasonal Variations in Demand for Currency Notes be met out of a Reserve?*

[Searching for some more effectual means of reducing the Currency Notes in the possession of the ordinary banks and the public, I was struck by the fact that the Bank of England showed in its weekly published balance sheet not a single £1 or 10*s.* note. If, I thought, it would proceed to form a reserve of currency notes, comparable in magnitude to its reserve of its own notes, two birds would be killed with one stone. First, provided that the required stock was taken out of the existing circulation and not merely obtained by a fresh printing, the notes would be brought nearer, if not quite to, par with gold; second, if the reserve thus collected provided for seasonal fluctuations in the amount, the Paper Goose would be sterilized, since it would become practically impossible for the Treasury to shelter itself behind the usual excuse for additional issue—"the banks wanted it for purposes of their business."

I therefore wrote the following letter to *The Times*, which appeared on October 28. The weak point of it is that it says nothing about the cost to the bank of keeping all this money idle. Obviously that should fall on the issuer of the currency in question, i.e., the Currency Note Account, which in the long run means the Treasury, as the profits of the issue eventually find their way into the Exchequer. The point is taken up below, pp. 203, 217.]

SIR,—

Many of your correspondents on the currency desire the immediate collection of gold as a backing for currency notes. But is it not fairly obvious that a gold reserve against a note issue is useless as long as the gold cannot be paid out, and that

it cannot be paid out as long as the notes are not equal in value to the gold they are supposed to represent? So long, for example, as it takes twenty-three £1 notes to buy twenty sovereigns immediately outside the country, we may be sure that no one will be allowed to make the profit involved in presenting notes for payment in sovereigns at par and exporting the sovereigns. (Hence the present prohibition of export of gold, which is equivalent to inconvertibility of notes). The use of a gold reserve against notes is to ensure convertibility, and if convertibility into freely exportable and meltable gold is not and cannot be present, a gold reserve is immobilized and, for the moment, useless.

Further, is it reasonable to recommend either the Government or the Bank to buy gold for this purpose when the price of gold is such that 23*s.* or thereabouts would have to be given for the gold wherewith to make a sovereign? The intention being to bring the £1 note and the sovereign to an equality, it would be extremely silly to buy gold before that equality is brought about.

Now I find that when it is proposed to reach that equality by the simple process of the Treasury ceasing to issue additional notes, and burning some of the already existing issue as they come in, the question is often asked, "But what would then happen when a bank with a sum to its credit at the Bank of England drew a cheque and said it wanted a million currency notes?" The idea in the mind of the questioner is that it is obvious that the demand can only be satisfied by the Government printing additional notes. But why cannot the million notes be supplied from a stock of old notes in the same way as a similar demand for sovereigns was supplied before the war from a stock of existing sovereigns? Before the war the Bank of England was not in the habit of specially digging a million in gold out of the mines every time a bank asked for a million of currency: it kept a reservoir of gold sufficiently full to be able to satisfy such demands. When currency notes were substituted for gold in the circulation, a similar reservoir of these notes should have been formed and maintained sufficiently full by ordinary banking methods to prevent every demand for a little extra currency having to be satisfied by the printing-press. But, perhaps confused by the fact that the Currency Notes Act intended notes

to be issued by way of loan,[1] neither the Treasury nor the Bank of England seem to have formed such a reservoir. In fact, the weekly return of the Bank does not appear to admit that the Bank possesses a single currency note, though it is difficult to believe that it is the one institution in the country which can do without the most commonly used currency.

What I should like to know is whether the immediate formation at the Bank of England of a substantial banking reserve of currency notes collected from the existing circulation (not created for the purpose by further use of the printing-press) would not be the best way of causing that contraction of the circulation which is necessary to bring £1 sterling to a par with gold, without preventing the occasional fluctuations in the total of the circulation, which are wholesome and necessary.

§ 3. *The Reserve Proposal Defended.*

[A letter to a Financial Authority.]

October 29, 1919.

DEAR——

. . . I think you are wrong if you hold that ordinary banking methods would not maintain a reserve of inconvertible paper just as well as they maintained a gold reserve. You say that raising the Bank Rate would not bring in *gold*. Certainly it wouldn't (until Bradburies came up to par—then it would), but we are not talking of keeping up a gold reserve but a reserve of notes. I think you suggest that raising the bank rate would not bring in notes because there are none (which is not quite true, but no matter) outside the country to be drawn in. There we touch a fault in most of the traditional theory of money, which seems constantly to require the existence of an outside world to make it work. That is quite wrong: the world itself is isolated, and you could have a common currency all over it

[1] The Act (425 Geo. V, ch. 14) says in § 2: "Currency notes may be issued to such persons and in such manner as the Treasury direct, but the amount of any notes issued to any person shall, by virtue of this Act and without registration or further assurance, be a floating charge in priority to all other charges, whether under statute or otherwise, on the assets of that person." This seems to make it clear that "The Treasury may, subject to the provisions of this Act, issue currency notes" in § 1 was intended to authorize the Treasury to lend notes, not to exchange them for coin or goods.]

and a Bank of Mundus which could act as the bankers' bank and keep a reserve in exactly the same way as the Bank of England used to do, and fix an equally effectual bank rate, though there would be no foreign parts from which gold could be drawn. I fancy the old methods applied to a purely local inconvertible currency would really be more immediately effectual than when applied to a world currency. You cannot really think that the Bank could not get in currency notes by the same methods as it used to get gold If somebody of accepted solvency would pay the expenses I would undertake to get in 50 millions very quickly by offering 20 per cent. on deposits!

Granting all this, you object that formerly the local currency could be enlarged by pinching the people outside the country, and under my system it could not. But surely we don't want to enlarge the local currency but to reduce it until it comes up to par. The elasticity which I admit to be desirable is not what the bankers seem mostly to mean by it, a possibility of perpetual extension, but the elasticity of a sound rubber ring which pulls in as well as stretches out: the reserve will provide for *temporary fluctuations*: I don't want it to provide for perpetual increase but to help towards a steady decrease. I am not afraid of the banks feeling "short of cash"; that is just what they and the Government and other people *ought* to feel because it would lead them all to do what is required. If it is desired to prevent people feeling short, double the currency, as the Germans have done since the Armistice, and bring the pound down to 20 or some smaller number of grains of standard gold instead of 107, as I think it is at present, and 123¼, as it ought to be!

I quite admit that a person above human failings might manage the Treasury issue so as to allow temporary fluctuations and yet steadily on the whole diminish the issue, but in fact the Treasury while allowing temporary fluctuations on the whole steadily increased the issue up to April 23 and since then has not materially decreased it, although the need for currency is immensely diminished by the reunion of husbands and wives, etc. And I think if temporary fluctuations were made to fall on a reserve it would be much easier to secure the gradual steady reduction which almost every one admits is required, though they keep on saying that nobody must be short of money.

The effect of accumulating bank-notes in the Currency Note Account has so far simply been to increase the currency notes and reduce the bank-notes by an equivalent amount. You can see that if you reflect that if the Treasury chose it could now easily exchange the £1,750,000 bank-notes for 1,750,000 currency notes now outstanding and burn the currency notes, and that this is obviously the best thing to do, unless it is prepared to use the bank-notes as a reserve to be paid out when required and recovered as soon as possible. But I would prefer the Bank to keep the reserve, as it controls the Bank rate.

§ 4. *The Reserve Proposal Explained.*

[A letter to Lord D'Abernon, who had moved in the House of Lords for a return which, when published, was called "Statements of Production, Price Movements and Currency Expansion in Certain Countries," Cmd. 434, followed by Cmd. 734.]

November 9, 1919.

DEAR LORD D'ABERNON,—

I hope a good deal from a plain statement of the increases of currency and of prices side by side. I wish we could get periodical statements, say once a week, of the number of grains of gold which each of the units (£, franc, mark, etc.) of currency is worth, as the public is completely fogged by the measurement in £, and so are the departments if we may judge from the ridiculous Parliamentary paper which was issued purporting to show that the pound sterling was worth 17*s*. in New York and £6 or something like that in Berlin and so on.

When I wrote that letter in *The Times* of October 28, I avoided censure of past action in order not to excite opposition, but it seems to me that the historian of the future will say that in 1914 the Bank took advantage of the Currency Notes Act (or its misinterpretation[1]) to shuffle out of its responsibility as banker to the other banks, while the Treasury did not take the business over. Apparently ever since then the Bank has considered it no part of its duty to meet from its own resources, cheques drawn upon it by the other banks which have balances with it: it has said in effect, "Sorry, but we have not got anything under £5 ourselves. However, it doesn't matter, we can get the

[[1] See note on p. 190 above.]

Treasury to print you a lot of nice new Bradburies." So instead of cheques being met by paying out of a limited amount of currency, of which the Bank had to keep a proper reserve in hand, they came to be met by the printing-press. There was of course nothing whatever in the Act to compel the Treasury to print more notes: the cheques are drawn on the Bank of England and the Treasury could always have said to the Bank, "This is your affair: you admit that you owe Barclays two millions, and yet you make a fuss because they ask you to pay £50,000 of it in Bradburies. There are plenty of Bradburies in the country, and you ought to be like other people and have enough to be able to pay what you have promised to pay when it is demanded." But this seems never to have occurred to either party, *Hinc illæ lacrimæ*. Refusal and consent to print might by an almost infinitely strong and wise person, be worked so as to be equivalent to the ordinary working of a bank reserve, but the Treasury is not such a person, and I am sure that the only way to put things right is to restore the reserve system and let bankers work by their old rules of thumb. This is confirmed by the almost universal incapacity to understand why the Bank Rate was raised the other day.

§ 5. *An Example of the Reserve System and How to Retain Subsidiary Coins.*

[The last sentence of the preceding letter evidently led up to the following letter which appeared in *The Times* of November 18, 1919. The plan of calling in the existing silver coins and reissuing them with more alloy was adopted in this country by the Silver Coinage Act, 1920, and was gradually carried out, though the danger of exportation of the coin had disappeared before the operation was even begun.]

SIR,—

On October 28 you printed my suggestion that the best step towards securing a currency not subject to indefinite increase and consequent indefinite depreciation would be to create and maintain by ordinary banking methods a central reserve of currency notes. What has happened since seems to show in a striking way the soundness of that suggestion. On November 6, immediately after a week in which over three millions had been

added to the currency note issue, the Bank Rate was raised from 5 to 6 per cent.

Now if there had been a reserve such as I propose, the addition to the circulation would have been taken out of the reserve, instead, as it was, out of the printing-press, and every one, except a few blinded by their own particular interest, would have understood and approved the rise as necessary to "protect the reserve" or to "stop the drain," in the good old phraseology. But as things were, a vast number of the people who profess to understand such matters declared that the action of the Bank was unintelligible, if not palpably absurd. They cannot see, and both as a teacher and as a student of the period 1797–1821, I think it will be impossible to make the most of them see, that as the indefinite multiplication of notes is admittedly ruinous, the printing-press requires "protection" against "drains" just as much as a reserve does, and that the protection can be given by the same means. It follows that, in order to secure support from general opinion and a consequent absence of friction, it would be better to set up a reserve and work by old-fashioned approved rules of thumb than to attempt to get the same result by applying the principles on which these rules rest to the control of the printing-press.

Turning to another currency question, I should like to express the astonishment which every one with any acquaintance with seventeenth and eighteenth century history must feel at the feeble way in which Governments are allowing their subsidiary silver coins to disappear. For more than a century it has been known that the only way to keep such coins in circulation is to rate them in the unit of account at more than their metallic value. It follows that if their metallic value rises, or, as is the case now, the value of the unit of account (the pound, franc, etc.) falls, so as to bring the metallic value above the rated value (e.g., so as to make the silver in a shilling worth more than one-twentieth of a pound note or the silver in a five-franc piece worth more than a five-franc note), the remedy is not to issue inconvenient paper substitutes, but to call in the existing coins, giving whatever small premium may be necessary for that purpose, and issue a new and lighter or more alloyed coinage. The operation will obviously be a profitable one to the State, while at the same time it preserves the public from an immense inconvenience. If

the Mint is incapable of coping with the work, the only thing to do is to "cry up" the coins by issuing a proclamation in the old form declaring that, e.g., the coin now called a shilling and passing at the rate of 20 to the pound shall be current for 2*s.*, and pass at 10 to the pound, and similarly with the other coins. This would be inconvenient until the coins were overstamped with the new values or recoined, but it would be less inconvenient than small notes. To the reproach of "debasement" the answer is that when the standard currency tells a lie, the subsidiary currency must tell the same lie. Small notes would certainly be no more honest than lighter shillings.

IV

AN ATTEMPT AT POPULAR PROPAGANDA: "PROSECUTE THE CHANCELLOR OF THE EXCHEQUER FOR PROFITEERING!"

[Despairing of influencing the authorities directly by argument, I cast academic calm away and appealed to the crowd. The following extract (No. 1) from the *Oxford Chronicle* of November 14, 1919, shows how I began. The "joke" found its way into a great many papers with larger circulations and led to the appearance of an article (No. 2) in the *Daily Mail* of November 24, illustrated with an out-of-date and somewhat terrible portrait not reproduced here.]

1. *The Worst Profiteering.*

[Extract from the *Oxford Chronicle*, Nov. 14, 1919.]

The first and for some time the only complaint received by the City of Oxford Profiteering Committee was from Dr. Edwin Cannan. It ran as follows:—

"I hereby complain of a commodity which costs less than a penny to produce being sold by retailers in this city and elsewhere at £1.

"The retailers are the banks, and the manufacturer is the Chancellor of the Exchequer, and the commodity is the one-pound currency note.

"I am, of course, aware that to prevent a thing being sold for the best possible price is the most effective means of preventing, or at least discouraging, its production, and I would not dream of putting the Profiteering Act in force in regard to any commodity

of a useful character. But the Currency Note, issued in its present excessive quantity, is far from being useful. On the contrary, it is extremely pernicious, inasmuch as it is a cause of the high and rising prices so much and so justly deplored by all well-disposed persons. It is a commonplace not only among economists but among all traders that the more plentiful any commodity is, the less it will fetch in the market, and it would be a very strange thing if currency were an exception to the rule. It is no exception, and the more plentiful a currency is, the less will any unit of it fetch or buy in the market—in other words, the higher will prices and the cost of living be.

"With the express object, therefore, of stopping the further manufacture of this article, I ask you to refer the case to the Board of Trade, and to demand the immediate prosecution of the Chancellor of the Exchequer for making the unreasonable profit of 23,900 per cent. at least on the sale of £1 currency notes, and half that amount on the 10*s.* note.

"If you regard the case as outside your scope, I suggest that you should resign, seeing that in trying to mop up a high price here and there without making any attempt to cut off one of the sources of the supply of paper-money which is devastating Europe and threatening the whole of mundane civilization, you will only be imitating Mrs. Partington."

The Town Clerk having acknowledged receipt, and expressed some doubt whether it was intended seriously, and also whether currency notes could be said to be sold, Dr. Cannan replied :—

"I am surprised that you should conceive it possible that I could joke on so serious a subject as the rise of prices. I leave that to the people whose money-incomes rise with the cost of living. At the same time I am not prepared to say that there is not something likely to make the pure cynic laugh in the spectacle of our own and other governments setting up absurd machinery for stopping people from charging high prices at the same time as they are themselves engaged in producing an inevitable rise all round by manufacturing additional currency with which to meet a part of their own expenses.

"I do not take your point that currency notes are not on sale. You will not find the least difficulty in purchasing a £1 note with a sovereign, nor even generally with 20*s.* in silver, at any bank in the town, to say nothing of the fact that drawing £1 notes out of a bank by cheque is indistinguishable from buying them, as your account is charged £1 for each.

"But obviously the retailers are not at all important in this matter. That the Treasury sells the notes, or, at any rate, that the 'banks pay for them outright' (instead of borrowing them as intended by the Currency Notes Act, 1911) is stated in the first

interim report of the Currency Committee, which is signed by Sir John Bradbury himself.

"What I am attempting to do is to give the committee something which they can send to the Board of Trade to show that the country is waking up to the obvious facts of the situation."

(It is understood that the Committee dismissed the complaint, and that it will not come before the public sitting, which is the first held in the City, on Friday.)

2. *Why Things are Dear.*

[Article in the *Daily Mail*, Nov. 24, 1916.]

Statistics are no doubt great fun, and it is nice to see the public laugh over my complaint to my local Profiteering Committee that the Government has been making the "unreasonable profit" of 23,900 per cent. on each £1 note if we put the cost of the paper and print as high as 1*d*. But, as I told our Town Clerk, the rise of prices is beyond a joke, and what I want to do is to make not only profiteering committees but also every one else see the root-cause of it and demand the one and only effectual remedy.

Of course the war started the rise, but how did it do it? And why does it continue after the war is over? Some people seem to think that before the war nobody wanted to make unreasonable profits, and others think that before the war wage-earners never asked for a rise of wages. But in fact before the war, as afterwards, profit-makers tried to make the best profit they could, and wage-earners tried to get the best wages they could. No explanation is to be found here.

Some say more plausibly that the war caused a general shortage of commodities and the scarcity raised prices. Supposing people's power to spend money had remained the same, there would be much to be said for this explanation: if a man had £100 a year and the things he usually bought became scarcer, he and others like him would be obliged by their own competition for the goods to give more for each. But if this were all, prices would have gone down rapidly as demobilization proceeded and would now be a great deal lower than a year ago. The real explanation is to be found not in the decrease of commodities but in the increase of money.

It is *spending money* that raises and maintains prices. If you and I and twenty million others were seized with a spending fever and rushed round to the shops where we were known and trusted and ordered monstrous quantities of goods to be sent home and charged to our account, there would be a general rise of retail and wholesale prices, but it would not last long, because when the bills came in we should find we could not pay, and if we did not sell the things ourselves in time the bailiffs would.

When the war began, the belligerent Governments rushed into the market and ordered monstrous quantities of goods quite regardless of expense, and there was an all-round rise of prices. The Governments were quite unable to pay out of revenue for what they had bought, and, what is more, they could not even borrow enough to meet their liabilities so long as the amount of money in their countries remained unaltered.

To avoid financial crashes, therefore, they issued, either directly or through State banks, quantities of additional paper money, which enabled them to pay what they had promised in the letter though not in the spirit, as the money possessed less purchasing power than that which existed in smaller quantity at the beginning of the war.

Then, by issuing still more additional paper, they were able to draw in most of the gold in circulation in their countries and send it abroad in purchase of goods which neutrals were willing to sell to them. Thus a great deal of the existing gold was sold to the neutral world in exchange for goods, while at the same time all the new gold produced from the mines was also sold to the neutral world, as the belligerents could not afford such a luxury—gold being one of the very few metals not used in munitions.

In these circumstances it is surely not surprising that the purchasing power of gold fell immensely, or, in other words, that prices reckoned in gold rose immensely.

But the European belligerents were not content with reducing the purchasing power of gold in this way. Impelled by their urgent need, and not sufficiently alive to the danger of the policy, they went on issuing more and more paper until the purchasing power of their money went far below the reduced purchasing power of the gold corresponding to it. And they did

not stop when the war ended, and few, if any, have stopped now.

The amount of money in circulation per head of the population is almost ludicrous. To every man, woman, and child in the United Kingdom there is now about £13 or £14 instead of only £4 or £5 before the war, and the amounts here are quite small compared with those in the other countries—the French have over 1,000 francs each (about £25 12*s*. 6*d*. at the present rate of exchange).

The result is that while a grain of gold will buy about half what it used to do, marks and francs and pounds will buy fewer of these depreciated grains. The mark, which used to be equal to six grains, is now worth little more than half a grain; the franc, which equalled five grains, is now worth less than three, and the pound, which equalled 123, is only worth about 103 [grains of standard, *i.e.* eleven-twelfths fine], at the present moment, and all of these moneys are falling.

The loss of purchasing power which gold has undergone is a matter for the world at large which cannot be much affected by the action of any one country, but why on the top of this depreciation of gold against commodities, should we pile a further depreciation of the pound sterling against gold, making prices about 20 per cent. higher than they would be if the £1 note was still worth as much as the 123 grains of gold in a sovereign?

To prevent prices rising still further and to bring them down a bit is perfectly simple—we must stop the further issue of currency notes and withdraw some of those that are now in circulation.

V

LETTERS ACCOMPANYING PRESENTATION COPIES OF THE PAPER POUND OF 1797–1821

1. *To the Governor of the Bank of England.*

December 14, 1919.

Dear Sir,—

Herewith I send you a reprint of the Bullion Report of 1810 with an Introduction in which I have sketched the history of the period of suspension of gold payments and to some extent

indicated the parallelism of that time and the present. I hope that you will have time to look at it and that when you have done with it you will place it in the Bank's library.

The Bank was severely blamed by many critics for its management of the paper currency of 1797-1821, but, as I have suggested on pp. xxxix–xli, if these critics could have known how very much worse the Governments of all the great European Powers would manage their paper currencies in 1914–19, they would have been more indulgent. In these days the one bright spot among a welter of mistakes and absurdities has been the recent increase of the Bank Rate, and I say God grant the Bank courage to raise it further and high enough, in spite of all ignorant and interested clamour! I think that the one hope is that the Bank will once more take the currency in hand itself and manage it on the old sound approved principles, as I have suggested in the two letters to *The Times* which I have pasted into the book.

That the paper currencies of Central and Eastern Europe will escape entire collapse is now most improbable, and it is scarcely likely that even the French currency will survive without a drastic writing down of its old relation to gold. And I rather think the end will come soon. I received a week or two ago in a closed envelope from Switzerland a kind of poster and also a leaflet printed in English by foreign printers the object of which was to advocate a general strike to enforce payment of wages in gold—or "at least" 50 per cent. in gold. DORA probably will prevent any wide circulation of such things in this country, but I have no doubt from the look of them that they are being circulated in other languages in continental countries, and will help to bring the currencies there into that discredit which is the final end of excessive issues. These countries may then, as I understand Mexico has recently done, take to actual gold again, which by increasing the demand for and consequently the commodity value or purchasing power of gold, would be likely to cause another great jump in its price in our paper.

If we do not stop the increasing divergence between our paper and gold very soon, I do not believe we shall ever be able to get back to the old par of £1 to 123¼ grains of standard gold. Will the Bank rise to the occasion—one of the greatest occasions in the history of the world—or will it let things slide?

2. *To the Secretary to the Treasury.*

December 21, 1919.

DEAR SIR,—

I send you herewith a copy of the *Paper Pound,* 1797–1821, a reprint of the Bullion Report with an Introduction, which I hope you will find of interest at the present time.

I have noticed a great change in opinion during the last few weeks, and it seems that we have now passed the phase during which it was necessary to argue with persons who denied that increasing a currency tended to raise prices reckoned in it. While the enormous rise in Government expenditure at the beginning of the war was no doubt everywhere the first cause of the depreciation of gold as against commodities and services and then of the depreciation of the belligerents' paper currencies against the depreciated gold, no one has been able to contend that the enormous increases which have taken place in most of these paper currencies since the Armistice have been caused by increasing Government expenditure, or are in any way the result of rising prices rather than their cause. The suggestion that the high price of commodities in general is due entirely to scarcity of goods and not at all to superfluity of money has looked very feeble ever since Lord D'Abernon obtained the return (Cmd. 434) which shows side by side the increases of currency and the decreases, if any, of goods produced. Whatever inaccuracies there may be in the figures for production, no one has any doubt that the increase of currencies has been enormous compared with the decrease of goods: and further, every one knows that production is gradually improving and yet prices continue to rise. We may in fact take it that the public is now willing to accept the judgment of the Bullion Committee, which said in 1810—

> "A general rise of all prices, a rise in the market price of gold, and a fall of the foreign exchanges will be the effect of an excessive quantity of circulating medium in a country which has adopted a currency not exportable to other countries, or not convertible at will into a coin which is exportable" (p. 17).

The only questions now are how far and in what manner the existing quantity of circulating medium in each country should be reduced.

Whether or not international arrangements for reducing instability of prices may eventually be desirable, there is, I think, general agreement that the paper currency of our own country should meantime be diminished until the pound sterling is again equal in value to a freely meltable and exportable sovereign of 123¼ grains of standard gold, or, in other words, until the market price of fine gold has fallen from the present height of 111*s.* per ounce to 84*s.* 11*d.*

The experience of 1815–21 (see pp. xxix to xxxiv of the Introduction) shows us both how to fail and how to succeed in raising the value of paper in relation to gold.

I. The way to fail is to issue more notes in order to buy gold, which by hypothesis is at a premium, with them. To do this simply tends to raise the value of gold throughout the world and to diminish the value of the notes, and so it tends to increase the premium on gold. The Bank of England in the 1815–19 period, with more patriotism than common sense, adopted the policy, and its failure stands on record. It may perhaps be said that there is no danger of its adoption at the present day, when the premium of gold is so much higher than at the earlier period. But there are certainly signs of a tendency towards its adoption. Instead of limiting the whole issue of Currency Notes, the proposal of the Cunliffe Committee, adopted by the Chancellor of the Exchequer, is to limit the fiduciary portion only. The Currency Notes are thus assimilated to Bank of England notes, and the total of the two together (which is the important thing) can only be increased if more gold is acquired and stored away. Now if in fact the existence of the premium on gold and the exercise of common sense jointly prevent the acquisition of such gold, the total of paper money will really be limited just as much as if it were limited in express terms. The total of Bank of England notes was limited in that way from the end of July, when the Bank ceased to be able to get gold without paying a premium, till a fortnight ago. But then the Bank suddenly, in some manner which has been kept secret, obtained four millions more gold, and this has enabled it once more to increase its issue. The acquisition of the gold which thus brought about a fresh and disastrous expansion of the currency was hailed in some quarters as "opportune"! It is clear that there are persons who will approve any amount of

expansion provided only that some body of persons is foolish enough to store away gold against the additional notes, though that gold, sold in the international market, would buy up all the additional notes and over 25 per cent. more!

It occurs to me as possible that the Bank secured the four millions from the Government by representing that the public were being inconvenienced by the practice recently adopted by the Treasury of using the issue of Currency Notes for the purpose of buying in and storing away Bank of England notes, which are all of larger denomination than Currency Notes and therefore more convenient for some purposes. To reduce the big notes while indefinitely increasing the small ones is certainly ludicrous, but the proper alternative is not an increase of the big ones but a diminution of the small ones. Instead of issuing more Currency Notes with which to buy up Bank of England notes, it is easy not to issue that amount of Currency Notes or to cancel that amount already in circulation. If the Treasury can afford to lock away a million in Bank Notes it can just as well afford to draw in and cancel a million in Currency Notes.

II. The one way to succeed in raising the value of the present paper pound is the old simple plan, adopted at last in 1819–21, of diminishing the aggregate amount of paper in circulation. It can be done conveniently by either of two methods, or, better, by both in conjunction.

(1) The Bank should abandon the fiction that it does not deal in Currency Notes, and should collect a sufficient amount of them to enable it to supply the Christmas and other seasonal or occasional demands for more than the normal amount of currency without difficulty. It could scarcely be expected to bear the loss which this accumulation of reserve would involve, and should therefore be assisted by the Government keeping larger deposits or otherwise, just as it was assisted in 1819.

(2) The Treasury should buy in and cancel Currency Notes at a fairly rapid pace, say three or four millions a week, until the pound sterling comes up to par—that is, until gold comes down to 84*s*. 11*d*. the fine ounce and the American exchange reverts to the neighbourhood of 4·86. The requisite funds can be obtained without legislation by selling securities held against the Currency Notes.

The objection commonly urged against this reduction of notes

in circulation is that it will make it more difficult for the Government and others to borrow. That it will make it more difficult to borrow *money* is perfectly true, but the real capital available for investment will not be in the least diminished. What will happen will be that the smaller sums of money which will be lent will go as far as the larger would have done. There will no doubt be a disagreeable feeling of tightness in the money market, but when a man is running headlong down a steep hill ending in a precipice, he does well to stop himself somehow, even at the cost of a few scratches or bruises. Delay is much more dangerous. Already an international propaganda is on foot against paper money, and I have received a poster and a handbill in English advocating a general strike to enforce the payment of wages in gold. It is clear that any such movement may easily bring crowns, marks, and francs into such hopeless discredit that they will be demonetized. The assignat experience may be repeated, so that we may find ourselves still on a depreciated paper standard while the continental countries have returned to a gold one like France under Napoleon, and Mexico this year. If such a return were accompanied by large demands for actual gold currency, gold would be appreciated by the new demand and the gap between it and our paper currency would be much widened.

1920

I

HOW ADDITIONAL CURRENCY IS PUT ON THE MARKET

[A review, written at the end of December, 1919, and published in the *Statistical Journal* for January, 1920, of R. G. Hawtrey, *Currency and Credit*, 1919.]

Mr. Hawtrey is one of the ablest and most learned of our currency experts. The historical chapters of his book provide much useful addition to knowledge. Readers may especially profit by his account of the manner in which a sudden return from a highly depreciated standard like the assignats to an earlier metallic standard has actually been effected. Who has not wondered what happened to debtors who had promised to pay tens of thousands of livres in the depreciated currency, or what will happen as between debtors and creditors in the future when the hopeless continental currencies are demonetized? Mr. Hawtrey tells us. Very usefully too, he draws attention to many cases in which a hitherto unexplained variation in the metallic value of a depreciated currency has been caused not by internal conditions but by a variation in the external value of the metal concerned. The enemies of depreciation, concentrating on the internal conditions which their own country can control, have generally if not always been right in disregarding these external changes, as they are usually quite trifling beside the changes inside, but it is a mistake to ignore them altogether.

On the theory of money, too, Mr. Hawtrey is acute and often enlightening. But there is much reason for thinking that in one important province he is fundamentally unsound. He begins with a chapter on "Credit without Money" in which he invents the "fantastic hypothesis," as he expects it will be called, of a

civilization without money where business is carried on by "credit," and shows that it would not work, as "prices released from any physical standard of value would vary without limit." He defends his plan on the ground that it makes clear the functions of credit, in which he is unduly sanguine, and also, "parenthetically," on the ground that the hypothesis is not entirely fantastic, since from 1797 to 1812 the English currency was inconvertible bank-notes which were not legal tender. This is making a fetish of the law: a legal-tender law is of no importance except in so far as it secures universal acceptance of the legal-tender coins or notes at their legal-tender value. If the people will accept them without such a law, the situation is exactly the same. Prices were limited by the limited amount of bank-notes from 1797 to 1812 just as much as they were afterwards: exactly why the Bank Directors did limit the amount of bank-notes may be a matter of dispute, but there is no doubt about the fact. A similar overestimate of the importance of legal technicality appears in Mr. Hawtrey's treatment of Gresham's law: he quite unnecessarily says there is an exception to the law if ordinary usage disregards the legal rating of a coin, whereas surely the "under-valuation" and "over-valuation" that should be meant in any enunciation of the law are the valuations at which the coins *actually* circulate.

A reader who is puzzled by the first chapter may well turn at once to the last page of the book, where he will find the following paragraph—

"We have treated money as subsidiary to credit. In a highly developed system of deposit banking, such as that of England or the United States, the justification for this is obvious Purchasing power is created and extinguished in the form of credit. Even gold fresh from the mines is in the first instance sold to a bank in exchange for a credit; it is only coined and passed into circulation when the customers of the bank ask for it."

This is wrong, and its error will be obvious as soon as a mint is set up on the Rand, and the sovereigns coined there are divided between wages and other costs of working the mines and the profits of the owners. The interpolation of a bank between the goldminer and the mint does not make an atom of difference to the principle. Whether there are any banks or not, the gold produced is bartered away for other commodities and services

just as iron or coal are and with precisely similar effects. The purchasing power of the fresh gold is exercised at the moment when the producers offer it in exchange for other commodities or services, and they must do this at once unless they are prepared to stop their business and forgo the realization of profit. The offer tends to lower the value of gold bullion reckoned in commodities and services and to raise the value of commodities and services reckoned in gold bullion. If an ounce of uncoined gold is beginning to procure less commodities and services than an ounce of coined gold, and free coinage is in operation, some of the owners of the uncoined ounces at once get them coined and *spend* them, with the usual consequence of spending more money —a tendency to a rise of prices.

To represent the tons of gold which were produced and coined and introduced into the circulation because the Transvaal and Yukon producers wished to buy as much as possible with it as having got into circulation " when the customers of banks asked for it " may seem a harmless aberration. It might be so if it were not the fact that the error involved forms the foundation of the doctrine with which the Treasury defends (or till lately defended) the continued and unrestrained issue of Currency Notes. If it were true that gold only gets into circulation when the customers of banks ask for it, the same thing would hold of Currency Notes. The Treasury induced the Public Expenditure Committee to report that the straightforward plan of issuing additional notes directly in payments for commodities and services differed in its effect on prices from the Treasury plan of paying for them with already-issued notes drawn from the banks and then immediately giving the banks newly manufactured notes.[1] The distinction is adopted by Mr. Hawtrey on pages 49–52, but in a slightly altered form, as he makes it not a question between paying out first-hand or second-hand notes but between a state of things where the banking system is undeveloped or developed, which reminds us of Mun's chapter " Of the admirable feats supposed to be done by bankers." When the banking system is well developed he thinks that even if a government " directly defrays its own liabilities with notes fresh from the printing-press," it will be the action of the banks,

[[1] Above p. 162.]

"not the note issue, which directly affects the value of the monetary unit." Apparently he supposes this will happen because the notes will "come back to the banks as they are spent." The spending here contemplated appears from the context to be not the first spending, that of the Government, but the second spending, that of the persons who received the notes from the Government. These two spendings—these two exercises of additional (reckoned in the money unit) purchasing power—will of course have raised prices, but Mr. Hawtrey seems to assume that the rise must now be somehow wiped out by the fact that the traders proceed to pay the additional notes into their accounts. Well, it is true that if they did not draw out any of their thus swollen balances and the banks preferred to lock away the additional notes thus come into their possession instead of lending them to borrowers or otherwise parting with them, the additional notes would cease to operate on prices. But unfortunately there is no justification for assuming that this would be the case. To talk as if the banks take the initiative when they merely carry on business in the ordinary way is, to put it mildly, misleading. To contend with Mr. Hawtrey on page 52 that "The only effective method of controlling the issues of paper money is to control the creation of credit, for the demand for legal tender money for circulation is consequential upon the supply of credit" is simply grotesque if the words are to be taken in their natural meaning. The issue can be carried on indefinitely or can be stopped dead at the will of the issuer. All that Mr. Hawtrey really means is that to keep the issue within proper bounds and to reduce it if it has gone beyond them needs both pluck and self-denial on the part of the issuers.

An able, important, and very dangerous work.

II

WHAT IS THE TRUE PURPOSE OF A RISE OF BANK RATE?

[A common objection to a rise in the Bank Rate about this period was the allegation that in pre-war times the purpose of a rise was to bring in gold, and that, as in existing circumstances it certainly would not do

that, it had become useless. The following letter on the subject was published in the *Economist* of January 10, 1920. The editor appended a note, which, with the discussion to which it gave rise in the next issue of the paper, added nothing on the question whether the Bank Rate had become inefficient, now that a rise of the Rate could not be expected to attract gold.]

SIR,—

In your last issue you express the opinion that under our present currency system with depreciated notes not convertible into free gold, raising the Bank Rate has lost all its efficiency, and you therefore disapprove of the recent increase to 6 per cent. You would, I suppose, favour an immediate return to 5 per cent. But if so, why not go lower, to 4, or to the "sweet simplicity" of 3, or even to 2 or 1? We should then have all the advantages which you attribute to 5 per cent., but in a greater degree!

My question is by no means original. It was put to the Governor and Deputy-Governor of the Bank by the Bullion Committee in 1810, and they said inflation would not be in the least increased by lowering the rate. But subsequently they got a friend to withdraw this statement in the House of Commons, and thereby abandoned their case (and yours).

The idea that the good effect of a rise in the rate charged and obtained for money by lenders was that it brought in gold to, in your words, "increase the basis of credit," and therefore presumably to enlarge the credit or inflation built on that basis, seems both perverse and superficial. Credit did not want enlarging but restricting, and the good effect of the rise was that it did restrict credit, and thereby diminished spending. The diminution of spending caused prices to fall, or, in other words, the value or purchasing power of currency to rise, which is exactly what is wanted at present. The coming in of gold in pre-war times was the eventual result and termination of the process, like the overflow of a full cistern. To object to raising the rate because the pound sterling is so depreciated that its purchasing power will have to be very considerably raised before gold begins to come in is very like objecting to filling your very empty cistern because it will be some time before you can fill it to the top.

I repeat then, if 6 per cent. is no use, of what use is 5 per cent.? Would it not be much more pleasant for the Government and

other people to borrow at 1 per cent.? It can be done quite easily—even the idea that it costs paper is a delusion: it is only a matter of printing "£10" instead of "£1," and "ten pounds" instead of "one pound" on the same number of scraps of paper.

III

SCHEMES FOR BUILDING HOUSES WITHOUT HAVING TO PAY FOR THEM

[Early in January, 1920, I received a cry for help from Wigan. It seems that some member of the Sheffield City Council had proposed that instead of borrowing and paying interest, the Council should apply to Parliament for power to issue currency "with due precautions against extravagant issues" or "alternatively for the Treasury to issue notes on the pledge" of the City's property and rates, "thus enabling the City to obtain the capital it requires free of interest and reducing the cost of public services and the rent of houses to a minimum and otherwise assisting the development of the City and the welfare of its inhabitants." There was no seconder in Sheffield, but the idea travelled to Wigan and was taken up by the Labour Party there, who proceeded to claim that "the Government should supply corporations with paper money at the cost of production, say, eighteenpence for a thousand notes," which would reduce the "economic rents" of the houses to be built by one-half. In support of the proposal, the old story of Guernsey's market-house was appealed to. I replied to the request for assistance in the following letter.]

January 9, 1920.

DEAR SIR,—

. . . Your labour party . . . wish to issue bits of paper in exchange for which the borough will get bricks and labour to build houses with. It sounds very fine till you ask "who is going to suffer?" Is nobody going to pay for these houses? The bricks and labour are to be given by the brickmakers and the builders in exchange for these bits of paper, which they cannot eat nor use as raiment. They will, it is said, be able to buy food and clothes with them: perhaps, but that only means putting the cheat one degree further off—if the notes are paid away by the immediate receivers to others, it is these others who will get bits of paper in exchange for real goods and services. However far you carry it, you cannot get out of the fact that Wigan will have got, not "ninepence for fourpence," but houses

for nothing except the cost of making a good many little bits of paper—in fact, this is the very object of the scheme. Isn't it obvious that somebody must lose by the transaction ?

The people who lose are those who have money in hand or are entitled to receive fixed sums of money : for the effect of spending additional supplies of money is to make money—the pound (and its twentieth, the shilling, and its 240th, the penny) cheaper, that is, able to buy less than before. Wigan's issue to build houses would not cheat the world at large much more than the Guernsey issue to build a market-house ; but why stop there ? Why not supply all the capital expenditure of Wigan in the same way ? Why stop at capital ? Why not abolish rates, by issuing a sufficiency of notes every year to meet all expenses ? And will the rest of the country and the world be content to see itself exploited by Wigan ? Every other town must do the same, and in a year's time the £1 note will not buy as much as a penny does to-day.

Your labour party is quite behind the times. The world is sick of paper money and the perpetual rise of prices which it causes. I have before me a poster and a handbill printed in Switzerland in English (among, I believe, other languages) demanding a general strike to enforce payment of wages in gold ! And just at this moment our own Treasury, frightened at last by the depreciation of the Currency Note, has put a limit of issue upon it.

The Guernsey incident is referred to in many books, e.g., Jevons' *Money and the Medium of Exchange*, but I don't know of any definite detailed account of it : [1] no doubt you will hear from your Guernsey correspondent. Guernsey is a sovereign State and could do what it liked even if that were obviously detrimental to the general good : if Guernsey was circulating gold and substituted paper, it must have bought the market-house from the world at large by exporting that amount of gold, which would diminish the purchasing power of gold throughout the world, but of course very slightly. Wigan isn't a sovereign State, and the only currency it could now push out, if allowed to issue its own, would be Currency Notes, and these (with all

[[1] I overlooked J. T. Harris, *An Example in Communal Currency*, 1911. The amount of money raised was only £5,000.]

other £ *s*. *d*.) would become further depreciated, but gold would be unaffected (except of course that it would be quoted at a still higher price in £ *s*. *d*. than it is now—110*s*. the fine ounce, instead of the par value 84*s*. 11*d*.)

IV

ANOTHER ATTEMPT AT POPULARIZATION

[The following special articles were written at the request of the *Manchester Guardian*, and appeared in the issues of January 30 and 31, 1920. The inclusion of Argentine among states allowing free dealings in gold was a mistake, and the statement that a sovereign once exported was free gold is too general: some European countries endeavoured to protect each other's paper currencies by prohibiting the melting of foreign coin.]

Paper Money and Prices.

§ 1. *What has Happened.*

Most people have at last begun to believe that, as they say, "all this paper money must have got something to do with the rise of prices," but they still say that they have not been given any simple explanation of the matter. I am going to make one more attempt to satisfy them.

Before the war our money was "on a gold basis," which meant that the pounds sterling in which prices and debts were expressed were always worth the same as 113 grains of pure gold. The pound was prevented from going above the value of that amount of gold by the fact that anyone in possession of the gold could get it coined into a sovereign, which would pay a debt of a pound or buy a thing priced at a pound; and the pound was prevented from going below the value of the gold by the fact that the sovereign could be melted down and made into watch-cases, dentist's wares, or foreign currency, as the holder pleased. The silver and bronze coins were manufactured by a monopolist, the Government, which only sold them to the public at the fixed rates of 20 shillings and 240 pence to £1, so that they maintained that value though the cost of material and manufacture was much less. Bank-notes were only printed records of promises to pay pounds, and could not fall in value below the cor-

responding number of sovereigns, because whenever people found any difficulty in passing them for that number they returned some to the bank of issue, until there only remained in circulation as many as would pass without difficulty.

In this state of things how much of commodities and services could be procured in exchange for or "bought with" £1 depended on or was the same thing with the value of gold, measured of course not in sovereigns, which were themselves nothing but stamped pieces of gold, but in other commodities and services. From about the beginning of the century gold had been losing value owing to the large annual supply from the mines, not counteracted by sufficiently large demand. Every ounce of gold produced, except the trifling quantity kept for additions to their own personal holdings of dental plates, watch-cases, and currency, is exchanged by the producers for other commodities and services. People sometimes talk as if all the gold produced was deposited in banks by the owners and these owners never asked for it again. This is quite absurd; the gold produced is obviously in effect divided between the miners, the persons who supply machinery, etc., to the mines, and the mine-owners, all of whom buy commodities and services with it, both when they "spend" and when they "invest." Whether the raw gold is sold for already existing money by the producers, who then spend that money, or is coined before it leaves their possession and is itself spent by them as money, makes no difference to the fact that the gold is offered in exchange for commodities and services. And the more that is offered the less will an ounce of it fetch, unless demand increases at the same time. Consequently before the war gold was slowly falling in value, which was the same thing as prices of commodities and services rising in our gold money.

Now, during and since the war the supply of gold, unlike most supplies, has gone on almost undiminished, while the demand of a large part of the world fell like a stone. Gold is apparently one of the few metals which was not required in the manufacture of munitions of war, and the hardly pressed belligerent Governments did not desire to buy it or to allow their subjects to buy it from abroad either for currency or ornament; the European belligerent countries thus ceased to take any of the gold that was being produced. Some of them even scraped together gold

from currency and ornaments and sent it to neutral countries to pay for munitions. Thus all the world's annual produce of gold and a little more has for five and a half years been disposed of in the portion of the world outside the distinctly war area, and has consequently fallen greatly in value measured in commodities and services. In other words, the prices of commodities and services in the countries, such as the United States and Argentina, which are still on a gold basis, reckoning their prices in gold and allowing gold bullion and gold coin to be freely dealt with, have risen greatly—in fact to more than double what they were before the war. These countries cannot be said to have brought the rise of prices on themselves; that they might perhaps have prevented it spreading to them by appropriate action is the worst that can be said against them. The active cause of the rise there is the refusal of the other countries to use as much gold as before the war.

These other countries, afflicted by the war as they were, might have issued only just enough paper to take the place of the gold currency which they sent abroad to buy munitions with, or they might have issued no more than the considerably larger amount which would have just put them on a level with the countries remaining on a gold basis. In fact they one and all issued much more, so that when the war was over, and gold and other commodities began to pass more freely from country to country, it was found that the currencies of these European belligerents were all depreciated against gold, and that in a greater or less degree according as the issue was more or less excessive. At the opening of 1920, nearly fourteen months after the Armistice, the Austrian krone had lost about 97½ per cent. of its former gold value, the German mark had lost about 89 per cent., the French franc about 50 per cent. and the English pound about 22 per cent. This loss of gold value was shown both in the price of gold as an article of commerce and in the foreign exchanges. For example, in this country fine gold, which when we were on a gold basis was priced at 85*s*. an ounce (because an ounce of it would make into 4¼ sovereigns), stood at the beginning of 1920 at 109*s*. and the value of a paper pound sterling in New York, which used to be $4·87, had sunk to $3·78. (People have sometimes carelessly said, "The sovereign has sunk to $3·78 in New York," but this is quite wrong. Here

in England a sovereign may not be melted or exported, and consequently it is only worth the same as a Bradbury. But once smuggled out of the country it is free gold, and in New York it can be turned into watch-cases, or into $4·87, just as before the war.)

In short, then, the European belligerents not only reduced the value of gold and raised gold prices all over the world, but also proceeded to reduce the value of their own paper currencies, and to raise their own prices of commodities and services, much further. Though there are only 113 grains of fine gold in a sovereign, what you can buy with 113 grains of fine gold will cost you £1 5*s*. 6*d*. in our currency. What an Austrian can buy with the gold contents of a 20 kr. piece will cost him many hundreds of krone in his present currency. For these additions to prices each separate country is individually responsible.

So much for the past. In the next article I propose to deal with the future.

§ 2. *Probabilities of the Future.*

Into the future of gold prices I do not propose at present to inquire. They can be regulated easily enough if the world will recognize facts and co-operate in regulating the output of gold and paper money. But at the moment this is a matter rather for Americans, and others who are still on a gold basis, to consider. On this side of the Atlantic our immediate concern is with the depreciation of paper money below gold.

One solution is to go on increasing the amount of paper money in circulation so rapidly that people decline to accept it, because they know that it will be worth less next week and much less next year. Business cannot be done, contracts cannot be made conveniently in such a medium. Somehow or other it will be abandoned in favour of something more stable, either a better paper medium or a metallic medium. History is full of examples of paper currencies which have disappeared owing to excess of issue. Only the other day the Mexicans, tired of a surfeit of paper, returned to the use of metal. The depreciated paper currency is then got rid of by being put in the waste-paper basket, and that this will be the fate of some of the present European currencies no one really doubts.

Another solution is to accept the existing depreciation, but

to prevent it going further by stopping the increase of the amount in circulation. For the Austrians, who are said to have issued a milliard (i.e., one thousand millions) of crowns in the last week of 1919, and for the Germans, who issued a milliard and a quarter of marks in the week before Christmas, to stop is perhaps impossible. For the French, who issued 386 millions of francs in the week ending January 2, it must be difficult. For our own country, in which the increase of currency during the past year has been only about one-fourteenth of what the German increase has been, it should be easy enough.

A third solution is to improve upon the last by reducing the currency enough to bring it back to its old gold value. Considering the comparative smallness of the depreciation as against gold and its recent date, and on the other hand the desirability of being on the same basis with America and other gold-using countries, I do not think we ought to have any hesitation in deciding in favour of this. It is quite a simple matter.

The way to fail to accomplish the end in view is to follow the course adopted by the Bank of England in the 1815–19 period, the plan of issuing more notes in order to buy gold with them. To do this merely tends to widen the gap between gold and currency since it increases the demand for gold in the world at large and increases the supply of notes within the country, so that gold tends to appreciate and notes further to depreciate. It may be thought that there is no chance of such an absurd policy being adopted at the present day. Nobody, it may be said, could be so silly as to buy sovereigns at the price of a Bradbury and six shillings each, and put them in store to be used to redeem Bradburies at par! It would obviously be so much cheaper to use the same resources to buy Bradburies at once instead of sovereigns. If the Government has £1,000,000, obtained no matter how—by taxing, by borrowing, or by sale of goods,—it would be extremely silly to buy gold sufficient to make only 780,000 sovereigns (all it could get at present for the money) and store them away as "cover" for Bradburies; the cover could be of no use until the Bradburies rose to par, and then the amount would only cover 780,000 of them, whereas applied at once to redemption it would have cancelled a million. But there are strong signs of a hankering after this insane policy in the proposal of the Cunliffe Committee, adopted by the Chan-

cellor of the Exchequer, to limit, not the whole amount of currency notes, but the fiduciary portion (i.e., the portion not covered by gold) only.

The one way to succeed in raising the gold value of the present paper pound is the old, simple plan, finally adopted in 1819–21, of diminishing the aggregate of paper money in circulation. This can be done by two methods in conjunction.

In the first place, some millions of the existing currency notes should be drawn into the Bank of England by the usual banking methods adopted to increase a reserve. Such a reserve is necessary in order to meet Christmas and other occasional and temporary demands for additional currency. When it is depleted for such a purpose the Bank will see that it is filled up again after the need is over. The Bank could scarcely be expected to bear the cost of collecting this reserve, and could reasonably ask the Government to bear it. Secondly, the Treasury should buy in and cancel currency notes at a fairly rapid pace, say three or four millions a week, until the pound sterling comes up to par—that is, until gold comes down to 84*s.* 11*d.* the fine ounce and the American exchange reverts to the neighbourhood of 4·87. The requisite funds ought to be obtained out of surplus of revenue over expenditure, but if no such surplus is as yet attainable the Government should not hesitate to issue to the public interest-bearing securities in place of these non-interest-bearing semi-promises to pay pounds. Semi-promises I call them, because, though they do not expressly promise anything on their face, the Act under which they are issued provides that they shall be redeemable in gold coin at the Bank of England. It is a question for casuists how to defend the morality of nullifying that provision by the subsequent prohibition of the export of gold coin. To the ordinary honest man it seems about on a level with promising to give some one a horse and then handing over a dead one.

The expense in interest could not be very great, as the whole of the issue is only about £350,000,000, and probably the withdrawal of a quarter of this would be amply sufficient.[1] Five millions a year would be a cheap price to pay for a restoration

[1] [This estimate was well justified by subsequent experience. The £5 million in the next sentence was intended as a liberal allowance for interest on the estimated £87½ millions.]

of the gold basis at home and the setting of a good example abroad. To the hackneyed objection that the temporary stringency in the money market would "penalize trade and industry," the answer is that the real amount of resources available for additions to the material equipment of the country would obviously be not in the least diminished. A little less money would be available, but the remainder would buy more, so that borrowers would require smaller loans.

Of course, the process of deflation must be disagreeable to some persons—to those, that is, who will lose something by it. But fortunately most of them will be the same persons as those who have gained prodigiously by the inflation and consequent rise of prices. We need not waste tears over them.

When we have got back to the gold basis and stand on it along with America we can then take part in the international consideration of means for stabilizing that basis itself. Sufficient for the day and place is the cure of the special evil thereof. It is no use for us to complain that the old State system and the war in which it ended have raised gold prices when, in fact, by our own individual action we have quite gratuitously raised our own local paper prices 25 per cent. above gold prices and are by no means very certainly resolved not to widen the gap between paper and gold still further.

V

VERY CLOSE CORRESPONDENCE BETWEEN CURRENCY AND PRICE CHANGES NOT TO BE EXPECTED

[A letter to a banker. It must be borne in mind that the statistics of the Currency Note Account published weekly have greatly increased our knowledge of seasonal fluctuations since 1920.]

February 22, 1920.

DEAR MR. ——

Your letter of the 18th illustrates something of which we professional economists often have to complain, a disposition on the part of the public to expect the results of economic causes to appear much more immediately and obviously than they are at all likely to do. You are troubled because the reduction

of currency in the course of January did not produce a fall in the statistics of prices as collected for January 1 and February 2. But on grounds of time alone is not that unreasonable? When currency is reduced, the tendency is for prices to fall because, *ceteris paribus*, less money will be spent, while the quantity of goods and services on offer will be unaffected. If the issuers get in 100,000,000 notes, whether by taxation or by borrowing or by selling stores, and put them in the cellar or burn them, there will be less aggregate spending of money: (you may look askance at the "borrowing," but it is all right: unless the borrowing is really issue of some other currency in substitution, which is excluded by hypothesis, the lender will have less money to spend). But surely the less spending cannot be expected to affect prices at once: it does not even take place the moment the currency goes in to be cancelled, and if it did, some little time would be required for retailers to realize that their stocks were not going off quite so quickly and for this to be conveyed to the wholesalers, and then for both to give in to new and lower prices and for those to be collected and reported to the Board of Trade. It's more like pushing a mattress along the floor than pushing an iron bedstead: you push at one end and squeeze the thing up a good deal before it begins to move at the other end. Nicholson made out that there was three months lag between increase of currency and reported rise of prices in the early part of the war, but of course there cannot be any uniform period, as so much depends on anticipation, which will vary enormously, and sometimes be quite wrong. So much for *time*: I should expect the January reduction to be reflected in the February prices rather than in the January ones.

Next as to the obviousness. There is always the trouble that *cetera* are not *paria*. The effect of an increase or decrease of currency may be and generally is either masked or exaggerated by a counter or coincident alteration in the demand for it. We are told that at Christmas time there is an unusual demand for currency because people want for various reasons to have their pockets full in the week preceding the festival. Neither the increase of currency to provide for this extra demand nor the withdrawal of currency after it was over should be expected to make the least difference to prices: the special excess of spending at the period is quite normal and is provided for beforehand

by an unusual collection of goods in the shops and elsewhere. So far then as the great increase of December, 1919, was due to the ordinary Christmas demand, I should not expect either it or the corresponding diminution in January to have any effect at all upon prices. I don't know whether you bankers know very much about the varying demand for currency: if you do you keep it very much to yourselves, as we outside are in the blackest darkness on the matter. One thing that seems pretty plain, however, is that a smaller rather than a much larger currency was required after the war than during it. During the war a much larger quantity was required in consequence of the separation of families. As men and women were gradually sent home and reunited their budgets with the household one, they must have set free a considerable amount of currency, just as they did the opposite when they were called up. Instead of calling in the currency thus set free, the governments of this and other countries actually proceeded to add to the total outstanding, though they had always said that the war was what necessitated the previous additions, thus giving us the delightful doctrine that both the transition from peace to war and the transition from war to peace involve greater demand for currency. If they had only had the pluck to reduce by 50 millions instead of increasing by that amount, prices would be much lower now and "the pound would be looking the dollar in the face," and though there would have been a tight time for a bit, there would be very much less discontent than there is at the present moment.

I am not sure whether I understand what you mean by the rise of prices being "due to an increase in the cost of production measured in services." I take it that you mean that it is requiring more service or labour to produce the things of which the prices are rising. But I don't think that is true: Government obstruction of production is diminishing and surely the conditions generally are becoming more favourable. And if it were true, I would not grant that it was an argument against contraction of currency. If people's real wealth is diminishing, I think it most important to diminish their money-means at least equally, so as to make them appreciate their really unhappy position and take the necessary steps to improve it, instead of whining about profiteers.

VI

THE USUAL AND MOST CONVENIENT MEANING OF "INFLATION"

[A review of Professor Shield Nicholson's *Inflation*, 1919, in the *Economic Journal* for March, 1920.]

THE substance of *Inflation* was given in the summer of 1919 in lectures to the staff of Barclay's Bank. Professor Nicholson was "asked to make the subject as simple as possible and to go back to the foundations." Most economists would feel somewhat alarmed at having to address bank clerks on currency. The ordinary bank clerk, like men of other trades, finds the substance which he handles rather uninteresting, and fails to understand the excitement of the currency expert. One economist tells how when he remarked to the cashier, "Three million more Bradburies last week!" he received from the other side of the counter a pitying smile, and "Ah! I suppose you watch these things." Another, who casually condemned the issue as a cause of rising prices, was met with "What? More money raises prices?" But Professor Nicholson's bank clerks would be to some extent a picked audience, and he seems to have steered with success betwen the Scylla of assuming too much knowledge and the Charybdis of giving offence by assuming too much ignorance.

The first chapter describes the pre-war gold standard and its abandonment. The principle that the convertibility of a paper medium of exchange into gold is desirable simply because it is the best practical method so far discovered of limiting the issue of such paper is laid down and vigorously enforced. In the next chapter we get to the inflation resulting from the abandonment of the gold standard. The explanation of inflation is not quite satisfactory. First we are told that it "is by common consent the name of a monetary disease," which is perfectly true. "Inflation" in ordinary language, which is the most important language, has a "bad" sense; it is the people who think there is something "wrong" who say there is inflation, while those who are satisfied and do not want things altered deny the existence of inflation. But in the next paragraph Professor

Nicholson says the "best solution" "is to say that inflation means an abnormal increase of money." Now what is "abnormal" is not necessarily bad: we can have abnormal prosperity, abnormal cleverness, and perhaps even abnormal goodness, without being any the worse for it. We may surely have an abnormal increase of money in some circumstances without being the worse for it. The author admits this by going on to inquire (1) whether there has actually been an abnormal increase, and (2) whether the abnormal increase has been necessary and beneficial. Now no one contends that inflation is beneficial: if anyone thinks what has happened to be beneficial, he says there has been no inflation. It would seem better to accept the common implication of something "bad" in inflation, and to say that it means not abnormal but "improper or excessive" increase, an increase which ought not to have been allowed to take place or which ought not to have been allowed to be so great, as the case may be. Little difficulty arises from this nomenclature where it is increases of paper money which are concerned, because they are so commonly regarded as subject to the will of the issuer. Where abnormal increases of freely coined metallic money are caused by discovery of new sources of supply, whether a person says there is inflation or not depends on whether he thinks legislators have been guilty of dereliction of duty in not shutting down gold mines, taxing gold output, charging a seignorage on coinage, or adopting some other of the numerous possible expedients for stopping or checking an increase. As persons who take this view are not numerous, it is unusual to find the term inflation applied to increases of gold money and paper kept on a par with gold when the increase is due to discovery of new mines or new methods of extraction. The war has brought into prominence the intermediate case of an increase of gold money in one part of the world caused by other countries refusing to take the normal amount of new gold, and even sending out some of what they already have. Professor Nicholson hesitates to apply the term inflation to this case: there is, he says, "abnormal increase in the gold money—although we do not usually speak of an inflation of the gold in circulation" (p. 49). There is nothing in his own definition to prevent him calling it inflation, but he does not do so because at bottom he accepts the ordinary view that inflation is something blameworthy, and he

is not prepared to blame the Governments which have merely allowed their countries to be flooded by gold refused or displaced by the action of other Governments.

With the misconduct of these other Governments in not only keeping out and throwing out gold and thus raising prices all over the world but also issuing so much paper money that it fell in value below this depreciated gold, he deals very faithfully. It discouraged industry and thrift, it caused industrial unrest all over the world, and it saddled the countries with far greater debts than were necessary.

And the remedy? Firstly, a cessation of Government borrowing, since so long as a Government borrows it will go on watering the currency. This no doubt is true so long as the money borrowed is more than what can really be lent without watering the currency, as it was during the war and perhaps still is. Secondly, a rigid limitation on the increase of Currency Notes. Thirdly, a reduction of the amount in circulation "until the notes bear a reasonable proportion to the gold held as cover." We should rather expect this to read "until the £1 Currency Note is worth 123¼ grains of standard gold and about 4·87 in gold dollars," but it must be remembered that the book went to press before the great rise in the price of gold and fall of the American exchange had manifested itself. Professor Nicholson is doubtless assuming the restoration of parity, and is asking that even after that restoration the notes should not exceed the cover by an amount which might make it difficult to maintain convertibility in the event of some untoward incident.

The book concludes with a striking quotation from the *Pilgrim's Progress*, in which Bunyan describes the difficulties of Christian and Hopeful when they left the King's highway to go by the bypath. I suspect that the part of it which most appealed to Professor Nicholson was "They, looking before them, espied a man walking as they did (and his name was Vain-Confidence). . . . But behold the night came on and it grew very dark . . . and Vain-Confidence fell into a pit. . . . So they called to know the matter, but there was none to answer."

VII

BANKS AND THEIR DEPOSITORS NOT TO BLAME FOR THE INFLATION

[Part of a letter to *The Times* published March 23, 1920. A strange doctrine was preached in many quarters to the effect that it was not the Government with its issue of Currency Notes, but the banks with their deposits which had caused the depreciation of the pound. The first part of the letter is omitted, as it only repeated the case against the note-issue.]

. . . A new and special doctrine has been invented to justify the retention of our present over-issue. In other countries, say the teachers of this doctrine, where the currency has fallen below its gold value, there probably is over-issue; but in this country what is wrong is not the excess of paper currency, but the excess of bank deposits, which (they say) are purchasing power, and of which the increase has been much greater in absolute amount than the increase of currency; it is, they say, these bank deposits which have raised prices, and the increase of notes has only been a consequence of that rise of prices.

But what is this total of bank deposits? The aggregate of the amount of money which you and I and some millions of others choose to keep "at the bank," or, in other words, which we allow the banks to keep and use as they please, provided they give us back as much of it as we ask for at any time in business hours. It is "purchasing power" to us, no doubt, but power as yet by us unexercised; we have, so far, refrained from exercising the power in our possession; and since it is spending money which raises prices, and we have not spent this money, we cannot be accused of having raised prices simply because we have increased our balances—rather the contrary is the case: by not spending we have tended to reduce prices. Of course most of the purchasing power represented by the deposits has been exercised by some one, though not by us, since the banks have lent most of our money to borrowers, and borrowers do not borrow in order to hoard or to put the sum borrowed into a bank again, but in order to spend. Say the aggregate of deposits has increased a thousand millions, and that the banks have increased their cash by a hundred millions and lent the other

900 to the Government: then the Government will have spent 900 millions of our money on its various purposes—carrying on the war, subsidizing bread, and other things. But it will not have spent a penny more than if it had obtained the 900 millions direct from us.

Indeed, if it had taken over the banks at the beginning of the war as it did the railways, and had managed them a good deal better than it did the railways, it would actually have got the amount directly from us, just as it has been getting a much smaller amount from the Post Office Savings Bank.

However much an ex-Chancellor of the Exchequer who has become a bank chairman may prefer standing in a white sheet as banker to doing the same as Minister, it seems quite impossible to believe that the intervention of the banks between us, the depositors, on the one side and the Government on the other has had anything to do with the rise of prices.

The idea of those bankers who take blame to the banks seems to be that by some exercise of the black art they have "created" the extra thousand million of deposits out of nothing. But you and I and the other persons whose balances have increased can each of us explain how we have been able, and why we have preferred, to increase them. The principal factor has been the rise of prices, which, while our real position has often been worsened, so that some of us can enjoy less of the good things of this life, has caused our money receipts and our money outgoings to be greater than they were. The very natural result is that we can keep, and find it convenient to keep, larger sums "at the bank." If pounds came only to buy what halfpence do, deposits would soon rise to near 500 times their present amount. Instead of being a cause, the abnormal increase of deposits is one of the most obvious consequences of the rise of prices.

The erroneous belief that deposits are the cause of the rise of prices has been accompanied by a strange scheme for reducing them. It has been urged that the Government should reduce deposits by paying off, out of surpluses, its debt to the banks. This has lately been tried, and Mr. Chamberlain last week complained that as fast as he paid the banks off they lent the money to other people. What else could be expected? Are they to go to their depositors, to you and me, and say, "Look here: very sorry, but we want to reduce this inflation. Would you

mind reducing your balance, say 5 per cent.?" The only alternatives for them are either to lend the money again or to collect and store away cash.

To their credit be it said, recent returns suggest rather that they are to some extent embracing the second alternative. So far, so good: anyone who hoards up any part of a currency instead of spending it takes it off the market and raises its value—in other words, reduces prices. But surely Mr. Chamberlain cannot reasonably expect the Bank of England or the whole of the banks to do very much in this direction? After all, the Currency Notes are a Government issue, out of which the Government has directly drawn 300 millions. Instead of paying off 50, or perhaps 100, millions of debt which he owes to the banks, and then asking them to take his notes off the market at their expense, let him do it himself at the expense of the Exchequer. The financial community will squirm a little till it sees the American exchange steady near par, and all who are expecting to profit by higher prices in the future will cry out, but the man who will give Europe a lead in setting currency to rights need have no fear for his fame in history. He will have done more to stave off anarchy, bloodshed, and confusion than anyone else in the world.

VIII

A RETURN TO GOLD EASIER THAN IS SUPPOSED, AS WELL AS DESIRABLE

[A contribution, written early in March, 1920, to a discussion of a paper by Professor Gustav Cassel, entitled "Some Leading Propositions for an International Discussion of the World's Monetary Problem," which was circulated by the American Academy of Political and Social Science. The paper and the contributions to the discussion were published in the Academy's *Annals* for May, 1920, Vol. lxxxix, *Prices*.]

I AM entirely in agreement with Professor Cassel's explanation of the general rise of prices and of what is called the "dislocation of the exchanges." I applaud his exposure of the folly of supposing that a hoard of gold which no one may draw upon is of some immediate use in supporting the value of a paper currency, and I welcome his support for the doctrine which I have (without much success) been trying to teach the public, that the high profits

supposed to be due to some witchcraft called "profiteering" are simply the result of a depreciating currency which means a rise of prices between the time of buying and the time of selling.

As to remedies also I am in agreement with him. I am only inclined to add a little without taking away anything.

First, I think it should be clearly understood that a "discount policy" is not likely to work unless those who have to put it in force recognize that the purpose of it is to reduce the currency and are themselves in sympathy with this purpose. I do not believe, for example, that the Bank of England could bring the pound up to its proper value of 113 grains of fine gold or 4·86 dollars by putting the bank rate up unless the other banks and the Government saw that what was wanted was to reduce the outstanding amount of bank-notes and currency (usually called "Treasury") notes, and were really desirous that the reduction should take place. Consequently I put more faith in direct action for reducing currency. In England, at any rate, it is perfectly easy for the Government to reduce the bank-note currency by a very large amount in a very short time and without any expense but with considerable profit. Gold equal to a hundred and thirteen million sovereigns is held by the Bank of England against its notes. The notes are convertible, but if a private person presumes to convert them and then to export or melt the gold, the Government can and does prosecute him: no one, however, can prosecute the Government itself for drawing out and exporting as much gold as it can present notes for. The British Government, therefore, unlike all other institutions and persons, is able to procure with £1 what will pay a debt of nearly $4·86 in America, since it alone is able not only to get five sovereigns with a £5 Bank of England note but also to send the sovereigns abroad to be sold for what they will fetch. If, as is probable, it shrinks from thus affronting the worshippers of "gold backing," it can still reduce the Currency Notes by the simple process of getting some of them in by taxes, or by borrowing at interest, and cancelling them. Of course any of these methods will tend to cause an immediate rise in the money market rate of interest, but I do not think a rise so caused would excite nearly so much opposition as what would be called an "artificial" rise brought about for the purpose of reducing the currency.

Secondly, I think it is necessary to insist strongly on the fact that each country acting alone, however indebted and poverty-stricken it may be, has the power of bringing its money—its unit of account—into some fixed relation with gold and keeping it there. It may be impossible, or if not impossible very undesirable, for Germany to bring the mark up to the value of 24 cents, but it is quite possible for Germany alone to fix the mark at 1 cent or some rather higher figure, and very desirable that it should do so. To cure the violent variations in exchange which are the real evil of the "dislocation," what is required is for each of the countries not at present on a gold standard to come back to that standard, no matter, so far as civilization in general is concerned, what particular rate each of them may, having regard to its own circumstances, find convenient. This is not a matter for international action, and nothing but harm is done by the perpetual suggestion that the United States or all the countries with the least depreciated currencies are to take steps to rehabilitate the more depreciated currencies of other countries.

It is only after civilization has been restored by the re-establishment of the common monetary unit, i.e., an ounce of pure gold, which prevailed before the war throughout all the world except a portion of the East where silver was the unit, and a few disordered localities in the West, that international action is admissible.

There is no need for the restoration of gold as a standard to cause a great additional demand for it. There is no reason for giving up the circulation of paper and taking again to pockets and tills full of heavy metal. We in England do not want sovereigns and half-sovereigns again: we should have discarded them long ago like the Scotch and Irish and the inhabitants of most of the white colonies if our banks' convenience had not caused our legislature to persist in the prohibition of notes under £5. The stocks of gold in the banks and those which are hoarded away for the present by individuals are together quite sufficient to provide the reserves necessary for keeping the different paper currencies in their proper relation to each other and to gold. But the infirmities of reasoning power in the human race and the state of elementary instruction in economics are such that it is possible, as Professor Cassel fears, that the restoration of the gold standard may be accompanied by a large demand

for gold for currencies and reserves, even if it takes place as the considered policy of Governments. There is another possibility—that gold may be restored as a standard by the people independently of their Governments. Sickened by the perpetual depreciation of paper-money, a people has often refused to deal in it any more and has taken, in spite of its Government, to buying and selling in metal, and to circulating that metal instead of notes: if this should happen, as we are told it has already happened in Mexico, there would necessarily be a large demand for gold for currency.

It may be, therefore, that the restoration of the gold standard, in the absence of corrective measures, may involve a great and inconvenient drop in prices when reckoned in that standard.

On the other hand, nothing of this kind may occur. Professor Fisher may be right in believing that the demand for and the supply of gold will be in such relation that prices in gold will not fall, but will go on rising as they went on rising before the war, and that to an inconvenient extent.

If pressed for a guess, I should be inclined to hazard that the immediate result of the restoration will be a fall of prices, but that the old rise would soon be resumed. The thing that is most unlikely is that gold would be very stable. When my grandmother was told by one of her sons that he intended to "trust in Providence," she retorted, "I never saw any good come of that!" If mankind want a stable standard, they must bestir themselves to make one, and not trust that Providence will secure that gold or any other particular metal shall always buy the same quantity of goods in general.

IX

"THINGS ARE GOING WELL: LIE LOW AND SAY NUFFIN'"

[A Letter to Mr. Samuel Evans, of Johannesburg]

July 10, 1920.

DEAR MR. EVANS,—

. . . To turn to affairs here, the position is, I think, much better than it looks. It is true that even after the bank-notes

held in the Currency Note Account are deducted to avoid double reckoning (they are now £16 millions instead of 4 as at the beginning of the year), the total paper out is £23½ millions more than at the beginning of the year, but this amount is not supposed to be as much as the gold which has been surrendered to the Bank of England by the banks. They are said to have taken Bank and Currency Notes in exchange and to be holding these notes as tightly as they held the gold. I asked —— whether they would, and he said with fervour, "Of course: they are our reserves!" (voice heightening at the end). I notice, too, that there are no more but slightly less ten-shilling notes outstanding than a year ago. All this and some other things seem to point to the currency in the hands of the public having actually diminished, and there is no doubt that prices are falling in spite of the Board of Trade's index number of retail prices showing a rise every month.

With every one talking of the coming slump, unemployment, etc., I think we deflationists must congratulate ourselves that the reduction of currency is not obvious. Otherwise we should get the blame of the "check to trade" and there would arise a cry "Give us our daily Bradburies." As it is, the business people have further played into our hands by raising an immense agitation against excessive taxation caused by excessive expenditure and especially the excess profits tax. They are saying so loudly and so often that it is this which is going to ruin trade, that when the slump really comes they and other people will think that it really was that, and deflation won't get so much blame.

In these circumstances I am inclined to lie low and say nuffin' rather than to go about saying that the increase of paper has been stopped, and hence the fall of prices

Some time ago the idea was that the banks had the Government by the throat and could compel the issue of more Bradburies by refusing to take up Treasury bills as they matured, but I think this is now exploded: trade looking less prosperous, Government will be able to reborrow easier. The real difficulty will be in the reduction of money-wages: it will be largely due to the general acceptance of the false principle that wages should depend on the cost of living instead of on the value of the product. An aggravating detail is the acceptance of the index

number of retail prices instead of the old wholesale one: the latter is decidedly falling, while the other still continues to go up, largely in consequence of the increases of wages made in order to meet it. It will soon be hit by reduced spending power caused by unemployment, some of which might have been avoided if only the hint given by the wholesale index numbers had been taken.

I send you a bit of the *D. T.*, which will confirm your view about Egypt. Private information says it is in a very bad way and the two great origins of discontent were the way the Egyptians were made to perform *corvée* in Palestine (a belated recompense for the way they treated Jacob's family some thousands of years ago), and the rise of prices.

X

SOUTH AFRICA'S TRUE INTEREST: AND THE THEORY OF FOREIGN EXCHANGE

[When the War broke out, South Africa had still no mint, and consequently looked on gold as a thing which came out of the Rand mines and sovereigns as things which came in Union-Castle steamers from England. She was therefore not protected by the fact of being a great gold exporter from the fashionable nervous affection which led all the nations to put embargoes on the exportation of gold coin, though she could not follow the most of them in including gold bullion as well as coin under the embargo. The usual result followed, as described in the earlier pages of the second of the two papers which follow.]

1. *South Africa's interest in the continued use of Gold Money.*

[Published in the *Journal of the Chemical, Metallurgical and Mining Society of South Africa* for August, 1920, and reprinted in the Johannesburg *Star,* September 16.]

It is difficult to make out exactly what is thought at such a distance, but as far as I can judge from the literature which has reached me, there is some considerable haziness in South Africa about the root-cause of the present decline in the profitableness of gold-mining.

I do not see myself why there should be the least doubt that the decline is due to the diminished real value of gold, that is,

to its diminished power to buy commodities and services. All over the world, whether gold or silver or some depreciated paper currency is the actual standard in which prices of goods and services are reckoned, a man with an income of 100 or any other given number of ounces of gold is a much poorer man than he would have been before the war. In most countries, it is true, he can sell his gold for more money—more pounds sterling, more francs, more marks—than he could before the war, but the greater quantity of money has a smaller purchasing power, so that when he lays it out he finds that he has got far less of the commodities and services which he wishes to buy. Things have not yet settled down sufficiently to make the decline of purchasing power quite uniform, but the average for the world at large is probably in the neighbourhood of fifty per cent. This is common knowledge.

Now how can it be doubted that this diminution must be bad for the gold-mining industry? The only wonder is that its condition is not worse than it is. What would have happened to coal-mining or to iron-ore production if the purchasing power of coal or iron had fallen to one-half? Obviously many sources of coal and iron would have become impossible to work at a profit, and the profits of those which remained would have been greatly reduced. By making a very "poor mouth" the producers of a thing which has fallen in value may induce the persons from whom they buy machinery and labour to sacrifice something, but the competition of other industries will prevent this assistance from being important and lasting. Gold-producers are no exception to the rule, and when the value of gold falls they will have to give away more of it in payment for the machinery and labour which they require for their business. No premium on gold can mend matters, since the existence of a premium only means that the pound sterling, or the franc or mark or whatever the unit of currency may be, has lost its purchasing power even more than gold has done. When the paper pound sterling is worth only 3·89 American gold dollars instead of the par of 4·87, the gold-producer will get a premium of 25 per cent. if he sells for English pounds and none if he sells for American dollars, but the pounds which he gets will be worth precisely the same as the dollars. If gold-producers in America have so far suffered rather more from the decline in the pur-

chasing power of gold than those in South Africa, this is a merely temporary phenomenon, due to American gold-mining being more quickly affected by the competition of other industries than gold-mining in South Africa. It is certainly not due to the South Africans having been paid a premium which only makes the whole price which they get equal to that which the Americans get. The real question is how much machinery and labour an ounce of gold will buy.

The cause of the diminution in the purchasing power of gold is pretty obvious. It is to be found in the fact that many great and important countries under the stress of the war discarded gold to a prodigious extent. Instead of continuing to take their usual proportion of the annual production of new gold in order to maintain and add to their currencies, their ornaments, their dental plates and other things, they not only stopped that demand altogether, but even sold a considerable part of their pre-war stock of gold to neutral countries and to belligerents less pressed by the war than themselves, taking in exchange things of more direct use in warfare. Since the Armistice I dare say there has been some revival of the European ex-belligerents' demand for gold for industrial purposes, but it is safe to say that they have not imported a single ounce for currency purposes. There has been a little shifting—Germany has had to part with twelve million ounces—but certainly no increase in the aggregate of their gold stocks. If the same kind of thing had happened to any other metal—if, that is, the demand for it had fallen off to the same extent, does anyone doubt that its power to purchase other commodities and services would not have enormously declined? "The rest of the world," it may be thoughtlessly said, "has shown no reluctance to take the whole production of new gold and also the old stock parted with by the belligerents." Indeed? Why, then, did the European belligerents have to pay so dearly for their imported articles? The outside world has taken the gold indeed, but only at half-price—it has only given half the old quantity of commodities and services for each ounce of gold.

The one hope for the gold industry lies in the possibility of a revival of the demand for hard money in the great European countries. The paper standards which they have substituted are working so badly that it is quite impossible that they can

continue very long to be regulated, as they are at present, by the balance between the desire of Governments to spend money without raising taxes and their fear of discontent induced by perpetually rising prices. The United Kingdom and perhaps one or two other countries will probably in one way or another restrict their issues until their monetary unit comes up to its old parity with gold, and then the gradual increase of their reserves will re-establish a small demand for gold. It is not very probable that gold coins will come back into ordinary circulation in England, as the people are now used to notes and find them convenient, so that the demand for new gold which used to arise from the abrasion of the coin in circulation may be regarded as definitely lost. Some of the other more solvent countries will probably succeed in fixing a definite ratio between their currency unit and gold, not at the old par but some way below it. So far as the demand for gold is concerned, this is an unimportant detail: whether the old parity is restored or a new one adopted, the same amount of gold reserves will be required, and the active circulation of gold is equally improbable. More hopeful from the point of view of the gold-producers are those countries which seem likely to go on issuing more and more paper money until at last it becomes totally worthless. Experience —the last instance in Mexico—suggests that over-issue of paper money carried to the extreme drives people to transactions in metal and thus re-establishes a demand for metal to increase and maintain the currency. It is sometimes said that the countries with very depreciated paper currencies are too poor to buy gold, but a tolerable currency is a necessary of life, and if a Government goes on long providing an intolerable one, its people will manage somehow to provide themselves with a better. It must always be remembered that, as money is accepted in order to be passed away again, it does not strike the individual who has made, say, a pair of boots, as an extravagant action to buy half an ounce of coined gold with boots: on the contrary, he calls it selling the boots for good money and regards it as excellent business. Poverty will neither prevent the emergence of coins from holes in the thatch or in the garden nor prevent the export of goods in exchange for coins which can be obtained from abroad.

The conclusion from this is that a gold-producer lost to all

sense of patriotism and humanity and thinking only of his own interest as a gold-producer might wish to see all countries, including his own, issue paper money so rapidly as to bring it into complete disrepute all over the world at an early date, after which his own particular product would be in bigger demand than ever. But if a good citizen of his own country and of the world at large, he will join other good citizens in hoping that his own country and as many others as possible may keep out of the *débâcle*, and be preserved from all the miseries involved in an orgy of paper prices, followed by a slump and a necessary reopening of all contracts. This granted, his wishes will coincide with those of other citizens: he and they will both desire a speedy return by their own country and as many others as possible to the comparative security and stability of a gold standard.

I do not gather that anyone of influence in South Africa wishes £1 to be permanently less in value than the 113 grains of fine gold which go to make a sovereign. But to-day (July 8, 1920) £1 in London is only worth about 92 grains, while £1 in South Africa is worth nearly 99.[1] (It may seem odd that a full-weight sovereign, containing 113 grains, should pass current in circulation for 21 grains less in England and 14 grains less in South Africa, but this is explained by the fact that melting and exportation are prohibited in both countries, so that the value of the sovereign while inside the countries is forcibly kept down to the value of the paper £1: once get a sovereign out into the non-British world and its value rises to that of its metallic content.[2]) The question then arises: "Should South Africa, who wishes to restore her £1 eventually to its old value of 113 grains of gold, take the necessary steps to bring it up to that level without regard to the value of the £1 in the United Kingdom, or should she let her £1 down to the level of the United Kingdom £1 pending the recovery of the United Kingdom £1, or finally, should she be content to take a middle course, keeping her £1, as at present, higher than the U.K. £1, but not up to par?"

[1] I am not clear whether the market for uncoined gold is sufficiently free in South Africa to allow this value to be apparent there. It is quite obvious in London, where the United Kingdom £1 will buy 92 grains, and the South African £1 is worth 7 per cent. more than the United Kingdom £1.

[2] Subject to the qualification mentioned above, p. 212.

The arguments in favour of the first of these courses seem to me overwhelming. To bring the value of the South African £1 down from 99 to 92 grains of gold as a preliminary to raising it to 113 seems on the face of it absurd. It requires a further inflation and consequent further rise of all prices in South Africa with all the inconvenience and injustice of that process, only to be followed shortly by all the inconvenience and injustice of an equivalent fall of prices. There is nothing to be gained by it to set against this, so far as the mass of the community are concerned, though a few acute persons and possibly the banks may manage to make money out of both the rise and fall of prices by a timely transfer of their activities from one direction to the other. It seems to be supposed in some quarters that the person who wants to exchange the right to receive money in London for the right to receive money in South Africa is hurt by the fact that he only gets £93 in South Africa in exchange for his £100 in London, but if the exchange were levelled by further inflation of the South African currency, the £100 (less commission) which he would get would buy him no more of commodities and services than he can get at present for £93, so that he would not be at all better off.

The middle course, which means inaction till the United Kingdom deflates its currency sufficiently to bring the U.K. £1 up to the value of the South African £1, is not nearly so pernicious as the policy of dragging down the S.A. currency to the level of the U.K. currency, but there are grave objections to it. South Africa, as by far the largest producer of gold, has a heavy interest in keeping up a good price for that article in the world at large. The prudent leather merchant has always been credited with believing that there is "nothing like leather," and South Africa in her own interest should cultivate both by precept and example the doctrine that there is "nothing like gold." For her to discard the gold standard by enlarging her paper currency till she depreciated the value of her £1 from 113 grains to 99, much resembles the action of the bootmaker who declared that boots were unhealthy, and ostentatiously walked to his shop in cheap, though perhaps not very durable, sandals.

Not only is South Africa setting an example of a course of action which it is to her interest that the world should not adopt; she also involves herself in grave inconveniences from which

European countries adopting it have been exempt. In Europe everywhere depreciated paper has been quite readily accepted down to the present time: the most obvious and continuous fall in its value has not as yet led people to ask for payment in gold. In South Africa, on the other hand, I understand there are important elements in the population which display a wholesome distrust of paper. In consequence gold cannot be wholly removed from the circulation as in Europe. This would not matter much if the South African Government had as effective a control over exports of gold as is possessed by the Government of the British Islands: there is very little leakage of gold coins from the United Kingdom at present when anyone with a £1 note can get a sovereign from the Bank of England, and there would probably be only a trifling increase if much of the coin in the Bank was actually in circulation. But owing to the geographical and racial position of South Africa the smuggling out of sovereigns there cannot be kept within small bounds. To provide coins with 113 grains of gold in them and keep a sufficiency of them in circulation as only equal to notes worth considerably less than 113 grains, is certain to be a very expensive and will probably prove an impossible task.

I conclude therefore that South Africa in her own interest and in that of the British Empire and the world at large, should return to the gold standard as quickly as may be. To effect the return nothing appears to be necessary beyond a removal of the prohibition of the export of gold coin. To remove the prohibition without reasonable notice would of course be quite improper and might cause a disastrous crash. Less than twelve months' notice would, I should imagine, be unreasonable, and possibly a longer period would be required: it would be much better to fix a long period than a period so short that hopes would be entertained by parties opposed to the policy that it would have to be lengthened.

If the prohibition were removed without notice, the demand for coin for export would be so great that the banks would not be able to cash the notes for which payment in gold would be demanded. But if reasonable notice is given and it is believed that the thing will really come to pass, the banks will prepare for it by so ordering their affairs generally and their note-issues in particular, that there will no more be a run on them for gold

than there was upon the Bank of England when she resumed meeting her obligations in gold after the long suspension of 1797 to 1821.

2. *South Africa Made the Victim of Foreign Exchange Delusions.*

[A "Note" in the *Economic Journal* for December, 1920, on the *Report of the Select Committee on Embargo on Export of Specie,* House of Assembly Paper, June, 1920, Cape Town.]

If we had been asked in 1913 "What are the chances of South Africa deserting the gold standard in case of a European war?" we should probably have unhesitatingly rejected the idea as beyond the bounds of possibility, and, if we knew a little history, we should have backed our opinion by quoting the classic case of California, the gold-producing State of the American Union, holding firm to gold during the American Civil War. But now, at the end of September, 1920, the South African pound sterling is not only depreciated far below the value of the 113 grains of fine gold required to make a sovereign (or its equivalent, \$4·87 in Canadian or American gold coin), but well below the 91 grains which will buy 4·87 Canadian paper dollars, and even a little below the 82 grains which will buy an English, Australian, or New Zealand paper pound. To any Rip van Winkle who went to sleep in 1913 and awoke in 1920 this would be an astonishing phenomenon. The great gold-producing Dominion with a paper standard more below its par with gold than any other in the British Empire!

If our Winkle's awakening took place in South Africa and he inquired of the most intelligent and well-informed persons he would be likely to meet there why these things were so, he would probably be told that the cause was a scarcity of gold in South Africa due to its illicit exportation. "Illicit exportation!" we can imagine him exclaiming, "do you mean to say that you have prohibited the export of gold and yet have not enough? Why, when I went to sleep you were exporting over thirty millions a year, and yet you had plenty—more than enough, in fact, as the value of gold in other commodities was falling. What has happened? Have the mines given out?" "Oh, dear no!" the

answer would be; "of course, the gold output goes on being exported quite openly and lawfully. That is only a 'commercial product,' just the same as wool (see Minutes, Q. 202). The exportation which has troubled us and which we have tried to prevent, is the exportation of gold *coin*, and when we said 'gold' just now we meant that, as you would have known if you had not been asleep all this time." Winkle, unsatisfied, might go on to inquire why it should be legitimate and healthy to export 440 ounces of uncoined gold and ruinous smuggling to export exactly the same weight of fine gold in the form of 1,869 sovereigns, but to this question it is not likely that he would get any intelligible answer.

The explanation of the whole puzzle, like most explanations of economic facts, must be historical. During the war it was supposed to be a military measure of the first importance to "prevent gold getting into the hands of the enemy," and it was believed that one good measure towards this end was for each country, including in that term detached parts of the British Empire, to prohibit all unlicensed carrying out of gold, not only to the enemy, but to any part of the world. The war seems also to have somehow revived, not only among belligerents, but even among neutrals, the mediaeval fear of losing the currency. Consequently prohibitions of the exportation of any kind of gold, and also of the melting down of gold coin for any purpose whatever, became almost universal. A century ago such legislation was everywhere ineffective and consequently got little more than passing notice in the controversies of that time. But in the modern world, in islands such as the United Kingdom, Australia, and New Zealand, conditions are different, and infractions of the law can be kept within such small limits as to become practically unimportant. This makes it possible in such countries to issue enough paper money to bring the value of the unit of account below its par with gold without taking away its redeemability in (or, as is usually said, its convertibility into) gold coin. As some one said in one of the old Bullion debates, gold imprisoned in the coin is degraded to the level of the paper. We do not run to the Bank of England and demand sovereigns in exchange for our Bradburies, because we know that, as law-abiding people, we cannot use sovereigns otherwise than as currency, and that as currency they are worth no more than

Bradburies, though as free gold they would be worth 39 per cent. more. When a paper currency is convertible into free gold, it cannot go below its par with gold, because its convertibility limits the quantity of it which can be put into and kept in circulation: when it is convertible only into a coin which cannot be used otherwise than as currency, it can be issued just as freely as if it were wholly irredeemable, and with the same effect on the general purchasing power of the unit of account. Hence the fall below par of the British and Australasian pounds.

On the outbreak of the war the British Government induced the mine-owners to agree to hand over the whole output of the mines to it, so that the Union of South Africa had no need to concern itself with the export of uncoined gold; but it very naturally fell in with the prevailing fashion of prohibiting the export of coin. It further proceeded to make it easier for the banks to enlarge the paper currency by allowing them to issue £1 and 10*s*. notes, the old limit having been £5. If the exportation of coin could have been stopped as effectively as it was in the United Kingdom and Australasia, the South African banks would then have been in as proud a position as the Bank of England under the Restriction of 1797–1821, and nothing except their fear of the eventual removal of the embargo on export would have stood in the way of South African pounds falling to the value of Polish marks or Russian roubles. It is true that, unlike the Bank of England notes of 1797–1821, the notes were still convertible into coin, but that convertibility would have been a hollow mockery like the present convertibility of the Bradbury. But South Africa's intercourse with the rest of the world is not so easy for a Government to control as that of the United Kingdom and Australasia, partly because the Union is not an island, and partly because two sections of the population—Natives and Indians—do not belong to the governing democracy and also have connections with the outside. Consequently extensive smuggling out of gold coin was possible, and was sure to take place if made profitable.

This prevented the depreciation of the unit of account, the South African pound sterling, having quite the easy course which it had in the United Kingdom, Australia, and New Zealand. When the South African banks had issued so much paper that the South African pound became worth appreciably less than

113 grains of fine gold, they were asked to fulfil some of their promises to pay pounds by handing over sovereigns, and the sovereigns thus obtained were smuggled abroad and sold for more than the foreign currency equivalent of a South African pound. In order to meet this demand for sovereigns the banks were obliged to buy raw gold in London "at a premium," i.e., paying more than a South African pound for each 113 grains, and getting it coined in the usual way at the London Mint. In other words, the penalty which they had to pay for issuing too much paper was that they had to buy a certain number of sovereigns at perhaps 26*s*. or 28*s*. and pay them out at 20*s*. If the "leakage" of gold coin, as they appropriately called it, had gone on growing, it would have amounted to the same thing as a removal of the embargo on export, and have forced the banks to reduce their paper till one pound was again worth as much as 113 grains of gold. During the spring of 1920 this influence was sufficiently strong to cause an appreciable rise in the gold value of the South African pound and to make it break away from the United Kingdom pound, which it had up to that time closely followed.

It became clear that mere prohibition of the export of gold coin was not a sufficient protection for an over-issue of paper. If South Africa was determined to have a paper currency depreciated against gold, the obligation to redeem the paper in gold coin must be removed. Otherwise it would be better to recognize the situation formally by removing the ineffective embargo, which was only giving illicit profits to law-breakers.

The long-run interest of the gold-mine owners and workers, properly understood, was entirely in favour of the earliest possible removal of the embargo and return to the gold standard. The gold mines, in South Africa, as everywhere else in the world, are suffering from the diminution in the purchasing power of their product caused by the disuse of gold in circulation and reserves by the principal countries of Europe. The direct importance of South Africa as an absorber of gold for currency purposes is no doubt almost negligible, but as the chief gold producer of the world her example carries great weight. If South Africa, producing every year perhaps five times as much gold as she required for her whole stock of gold currency before the war, cannot afford to have a gold currency, who can? It is

not well for the village bootmaker to declare boots expensive and unhealthy and to parade himself and his family barefoot. To the leather merchant there is nothing like leather, and to the Transvaal there should be nothing like gold. Had the Union of South Africa never gone off the gold standard, the mine-owners might have been trusted to favour its continued maintenance.

But the standard having been abandoned, and the unit of account having been depreciated against gold, when the process was obscured, so to speak, by the smoke and dust of war, the mine-owners found that on the one hand the cost which they had to meet in South African currency had risen, owing to the increase of money-wages and prices caused by the additional paper, and most of them seem to have believed that, though a return to the gold standard would cause some diminution in the monetary amount of these costs, the diminution would not be equal to the loss which they would suffer by having to give more of their raw gold for a given amount of South African money. With the South African pound worth 82 grains, 82 grains plus cost of marketing will pay the workman in South Africa £1; the mine-owner asks himself in some complicated form: "If the pound rises to 113 grains, shall I be able to persuade that man to take $\frac{82}{113}$ of £1, which is 14*s*. 6*d*.?" No doubt there would be a loss under this head, which, though only temporary, as all prices adjust themselves in the long run, would never be directly recovered; but this special and limited loss ought to be faced in view of the general advantage to the gold industry of the restoration of the use of gold currency. The mine-owners, however, with the important exception of Mr. Samuel Evans, have not risen to this height, and are consequently for the most part but lukewarm supporters of a return to the gold standard.

At the end of March, 1920, the House of Assembly appointed a Committee "to inquire and report upon (*a*) the effect of the embargo on the export of specie upon the cost of living; (*b*) the desirability and practicability or otherwise, with a view to improving the economic conditions of the Union, of removing the embargo and of modifying the statutory provisions at present in force in regard to currency and banking."

Houses of Parliament in the British Dominions, and in the

mother-country also, would do well to recognize the fact that they do not contain experts on every subject, and are consequently incapable of appointing committees suitable for every kind of inquiry by selecting members entirely from their own body. It is no use to say that they will call, and be guided by, the evidence of expert witnesses. The expert witness who offers himself is by no means always the best who can be obtained. The wholly inexpert committee does not know whom to call, and when it has before it the right or the wrong expert, it does not know the right questions to ask him. The South African Committee of members of the House of Assembly, set up to consider currency and banking, consisted chiefly of men eminent in their particular line of life and possessing very considerable ability, but it does not seem to have included anyone who had any training in the theory of the subject. It would probably have been much more effective if it had included in its number either or both of the two Professors of Economics (Dr. Lehfeldt of Johannesburg and Mr. Leslie of Cape Town) whom it called as witnesses. Whether they were right or wrong in their recommendations, professional training and the practice of teaching would have enabled them to put more searching questions than the inexpert Committee was able to ask.

As it was, the Committee seems to have been clay in the hands of Mr. Henry Strakosch, a very able witness, usually resident in London, now managing director of one of the large gold-mine combinations, who had formerly passed through excellent practical experience of foreign exchanges in Europe and more recently had been concerned in the marketing of the gold product of South Africa in the world at large. He had written a pamphlet on what ought to be done in South Africa. The Committee began by considering this, and his evidence upon it occupies the first 162 of the 574 pages of evidence, although for 125 pages the questions are omitted, in order presumably to shorten the minutes.

Mr. Strakosch admitted that South African currency was depreciated against gold, that to maintain currency at a parity with gold it must be convertible into gold, and that to maintain foreign exchanges at par, coin and bullion must be freely exportable and importable, but held that South Africa could not " afford to re-establish and maintain its currency on a true gold basis "

at the present moment. As usual, when currencies once become depreciated, it is a case of "jam yesterday and jam to-morrow, but never jam to-day." The argument may be put under two heads: (1) It is undesirable to raise the South African pound to the value of 113 grains of gold; and (2) if it were so raised, it would be impossible to keep it there.

(1) The first head does not call for much comment. Mr. Strakosch adduced the objections which are commonly made to raising the value of the unit of account without adding anything fresh, and without any attempt to balance the advantages and disadvantages of a fairly rapid return to the gold standard against the advantages and disadvantages of his own plan of "wait and see." He laid much stress on the theory that if South Africa were on a gold basis while the United Kingdom was on a lower Bradbury basis, the United Kingdom investor would be deterred from investing in South Africa and the South African investor would be attracted to invest in the United Kingdom by the belief which each would have that the Bradbury is bound to rise to 113 grains of gold in the near future. He overlooked the fact that this belief is waning, and is likely to be further shaken by the coming collapse of continental paper currencies, so that gold standard countries are likely to come into greater favour with the investor, and he forgot that the coming of an alteration in the purchasing power of money affects what will be offered to the investor as well as what he will accept. If South African pounds were worth 113 grains and going to stay at that, while Bradburies were 82 and going to rise soon, it is true that a lender would prefer a long-term or perpetual 6 per cent. in Bradburies to the same rate in South African pounds; but it is equally clear that the borrower could well afford to offer a much higher rate of interest if the loan were contracted in South African pounds; since if he contracted in Bradburies he would soon be paying the same annual value as if he had received South African pounds, whereas, in fact, he only received on loan the same number of United Kingdom pounds, each worth only $\frac{82}{113}$ as much as a South African pound.

(2) On the second head, the impossibility of keeping the South African pound at 113 grains, supposing it to have once got there, Mr. Strakosch misled the Committee by completely ignoring the orthodox doctrine of the exchanges as taught by the econo-

mists. That doctrine has been so snowed under by neo-mercantilism in these latter days that even in the pages of an economic journal it may be useful to recapitulate it.

It is founded on (*a*) the truism that a currency or unit of account is valued for what it is worth, that is, for the commodities and services (let us say " goods " for short) which it will buy, and (*b*) on the well-established economic principle, to which currency is no exception, that variations in the supply of an article affect its value or power of buying, increases tending to reduce, and decreases to raise, its value. For an example of the truism we may say that Englishmen and others value American dollars because, and in so far as, those dollars will buy American goods ; Americans and others value English pounds because, and in so far as, those pounds will buy English goods. If dollars rise in purchasing power (in other words, if prices of goods fall in America) while pounds fall in purchasing power (in other words, if prices of goods rise in England) or remain stationary or rise less rapidly than dollars, fewer dollars will be worth as much as a pound, i.e., the exchange value of dollars in pounds will rise, and that of pounds in dollars will fall. For examples of the general principle that increase of supply tends to reduce the value of an article we need not search ; every one has everyday experience of its truth : that currency, whether metallic or paper, is an exception to the rule is believed by none but a few currency cranks who have never been able to produce the smallest logical justification for their view and have always had to fall back on gross misrepresentation of historical facts.

The truism and the principle together involve the consequence that the exchange between currencies can be kept close to a given rate by due regulation of their supply, whether that regulation is conscious or automatic. The Indian Government, by conscious regulation of the supply of rupees, kept the rupee approximately equal to one-fifteenth of 113 grains of fine gold, and therefore at a stable rate with all the gold-standard countries, for nearly twenty years before the war. Conscious regulation is simple enough ; automatic regulation is a little more difficult to understand. It takes place where two or more currencies are each in part at least composed of something which can be used at will for purchases in either or any of the countries concerned. Before the war, for example, English pounds and

American dollars were both in part gold pieces which could be lawfully transported from the one country to the other and be converted from one coin into the other at small expense. In practice the situation was very little different from what it would have been if sovereigns had been legal tender in America for $4·8665 and dollars legal tender in England for 4*s.* 1·32*d.* There could be no great variation in the exchanges between two or more countries linked together in this way, because if the purchasing power of the unit of currency fell for any reason in one country while the unit in another rose, remained stationary, or did not fall so fast; in other words, if prices of goods rose in one country while in another they fell, remained stationary, or did not rise so much, it immediately became profitable to send gold money from the first country to buy goods from the second. This promptly equalized matters, and stopped the tendency of the exchange-rate to diverge from the normal: that it must do so becomes obvious when we reflect that, for example, the sending of gold from England to America and the bringing of goods from America to England at once made gold scarcer in England and more plentiful in America, while at the same time it made goods scarcer in America and more plentiful in England. To the objection, sometimes urged, that gold was only a small portion of the currencies, the answer is, in the first place, that when a thing is nicely balanced a touch will make it swing, and, in the second place, that the existence of a very large paper currency beside the gold had no tendency to counteract the influence of movements of gold, but rather the contrary, inasmuch as the banking organization of each country secured that when gold left it the paper currency did not increase to take its place, but diminished, and that usually by a greater absolute amount than the gold currency.

In place of this old and well-established theory, Mr. Strakosch put before the Committee a doctrine that the stability of the exchanges before the war was due to the trade or transactions of the principal countries having—apparently quite fortuitously —" perfectly balanced " (QQ. 38, 165), while since the war it has been " out of balance " temporarily, though it must balance in the long run (Q. 200). No one asked how an account covering exports and imports, and all the transactions included by Mr. Strakosch and the Committee in " invisible exports and imports,"

could possibly fail to balance for even the shortest period of time. When the visible exports plus the invisible do not equal the visible imports plus the invisible, what does the difference consist of? Mr. Strakosch never explains this, but may be suspected of supposing it to consist of debt not intended to be of long duration; but the contraction of debt has already been set down as one of the items in the invisible imports and exports, and if the whole has not been included the item should be amended. The majority of the Committee, when they talk of "the maintenance of an excess of visible and invisible exports over visible and invisible imports" (*Report*, p. vi) are probably making the difference consist of coin imported, thus partially reverting to the mercantilist nomenclature, in which coin was not included in imports and exports. But the mercantilists excluded bullion as well as coin.

Having thoroughly confused the majority of the Committee with the chimera of a balance-sheet which does not balance, although the items on each side add up to equal amounts, Mr. Strakosch proceeded to terrify them with two bugbears—the Indian peasant, who would insist on buying gold at an outrageous price, and the United States, which had "lost" in nine months to March, 1920, 450 millions dollars' worth of gold. Instead of congratulating South Africa on still having in the East a tolerably good customer for her principal product, now terribly depreciated in purchasing power owing to the misfortunes of Europe; and instead of congratulating the United States on finding customers for this mass of metal which she took in exchange for goods during the war, which so far had done nothing for her except create disturbance by raising prices, and the export of which was likely to bring her prices down (as indeed it has), Mr. Strakosch argued that the United States would be obliged to restore her war-time embargo on the export of gold, and then, if South Africa was on a gold standard, allowing the export of specie, the all-devouring Indian peasant would soon draw away all the gold coin from her. Of course, if South Africa really were on a gold standard, nothing of the kind would happen, because the sovereigns in South Africa would then be no cheaper than 113 grains of gold produced from the mines, and there could be no reason for the Indian peasant to make a dead set at the South African currency.

Confused by all this, the Committee never seriously considered the real practical issue which should have been put before them —whether it would be best for South Africa to keep her currency level with gold or level with the British paper pound. There are many arguments for both courses, and this is not the place to attempt to decide between them. What the Committee—or at least the great majority of the Committee, since the small Labour element fought manfully for sound doctrine—decided to do was to recommend the continuance of the embargo, the discontinuance of the convertibility of paper into coin, and the creation of a new central bank of issue with power to issue unlimited bank-notes against 40 per cent. of gold. These proposals remove the two checks—" leakage " of coin by smuggling and the fear of a removal of the embargo—which restrained the banks in the manufacture of currency. On their face they substitute nothing except the requirement of 40 per cent. gold cover. Now, whatever may be thought of the usefulness of such a requirement when the paper is convertible, it is clear that when the paper is inconvertible and expected to remain so it will only stop the manufacture of paper pounds when their value is so reduced by over-issue that it will take nearly a hundred of them to buy gold enough to make forty sovereigns.

Until the new bank can be got into working order, the recommendation is that existing bank-notes shall be convertible only into gold certificates issued by the Treasury which are themselves inconvertible into the gold which they " certify ": the banks may increase their issues as they please, provided that they keep 40 per cent. reserve against the whole and pay 3 per cent. per annum on any excess of issue above that of December, 1919, and their issues will eventually be taken over by the new central bank.

This bank might, of course, determine to raise South Africa's currency to par with gold, and could do so by reducing the swollen paper issue, but a very different state of opinion will have to be created before it is likely that the board of management will even wish to return to the gold standard. It is much more likely only to desire to secure parity with the British pound, and knowledge of monetary theory will have to be considerably improved before it will be likely to know that, in order to maintain even that low standard, it must not yield to

what the Finance Secretary naïvely calls "the requirements of business"—as if business would not always "require" as much currency as banks and Governments are induced to create for it!

And though the requirement of 40 per cent. cover plus the tax of 3 per cent. on additions to their issues is a fairly strong brake (especially when the 40 per cent. means more than 40 per cent., because the centum is reckoned in a depreciated currency and the 40 in gold) and may perhaps prevent further increase of the paper currency by the existing banks, it is possible that the question may ultimately be not of maintaining a Bradbury standard, but of climbing up to that low level. For the Committee's Report and the progress of legislation on the lines it laid down were promptly followed by changes in values which have greatly widened the gap between the South African pound and gold, and have even brought it slightly below the Bradbury, though it was 7 per cent. above a few months ago.

It remains to be seen whether sounder views and better policy will be the result of this degradation of the South African currency, and of the fact that, instead of the United States having set a bad example by reimposing her war-time embargo on gold exports, as prophesied by Mr. Strakosch, Argentina is preparing to remove hers, and that the Indian situation has also changed in a way which should help to dissipate the groundless alarms with which he inspired the Committee. Much depends on the importance which the central bank and the existing banks attach to the sub-section (§ 7, iii) of the new law providing that the suspension of convertibility shall cease on June 30, 1923. If they really believe that the legislature will not continue it beyond that date, they will take the steps required in order to bring the pound gradually up to par with gold.

[Happily, the sounder policy was pursued. Mr. W. H. Clegg, from the Bank of England, became the first governor of the Reserve Bank. The South African pound was gradually brought up to par, and early in 1925 South Africa led the rest of the British Empire in its return to the gold standard.]

XI

ORTHODOX AND OTHER PRINCIPLES FOR THE REGULATION OF WAGES

[A letter in *The Times* of October 20, 1920.]

SIR,—

It seems desirable at the present juncture to call attention to a fundamental principle in regard to the regulation of wages which is being commonly overlooked. This is that in the pre-war past the wages of each occupation have been subject to change with the community's need of the particular service which it rendered, and that in the future it is desirable that they should continue to be subject to change in that way. When there was need of a relative increase in the supply of an article the price rose, and this encouraged further production by giving higher profits and higher wages, which attracted a larger proportion of the productive resources of the community into that particular branch of activity. Conversely, when there was less comparative need of the article, profits and wages fell, and the proportion of the productive resources of the community devoted to that branch diminished—take hansom cabs as a fairly recent example of an extreme case. The principle was an obviously sound one. Looked at from the point of view of the community at large it meant regulating the supply of labour to the different branches by raising and lowering the inducements to enter them, and it is difficult to see what other method except "industrial conscription," so justly abhorred, can be put in its place.

For some time the necessity of regulation in this sense has been overlaid, so to speak, by the need for altering money wages so as to make them conform with alterations in the purchasing power of money. It is, of course, quite true that if the community is stupid enough to allow its money to jump about in purchasing power, money-wages and other things also must be altered to correspond. But the fact that it may be necessary to alter money wages all round because of an alteration in the purchasing power of money—usually called an alteration in the cost of living, should not be allowed to blind us to the fact that particular

changes may be required for other reasons, nor make us argue every claim as if it could be settled by Board of Trade or other index numbers.

In the last few weeks an entirely new principle has been before us, and has been received with an astonishing amount of acceptance by the general public, though the miners will have none of it. This is the principle of making the wages paid in an occupation rise and fall with increases and decreases in the aggregate output of the occupation. For a strictly limited period to meet a temporary emergency it might conceivably be well to adopt this principle, and I do not wish to condemn the Government's recent proposal if it was only intended to remain in force for a month or two while more permanent arrangements were being negotiated. But I do protest against the plan being regarded as a desirable or even a possible way of regulating wages permanently, and experience shows that there is very great danger of expedients intended to be purely temporary continuing in force for considerable periods, with disastrous results. If successful, the plan of paying wages according to aggregate output must necessarily end in an *impasse*. The natural tendency of increasing aggregate output is to diminish the value of the unit of output, and eventually even to diminish the total value of the aggregate output—as in the hackneyed example of the big harvest worth less than the little one, which is quite right and proper ; under the old system this diminution of value acted as a natural and easy check on the further application of resources to any particular branch of production by reducing the profits and wages obtainable in it, but under the proposed system of paying wage bonuses on aggregate output, wages must remain undiminished, if they be not positively increased, no matter how far increase of quantity may have diminished the value of the product. It is obvious that no industry could be long carried on under this plan without a subsidy from taxation if the bonuses were really effective in causing continuous increase of output.

The moral of all this for the moment is that the miners by rejecting the proposal for a bonus in proportion to output have very probably saved the State from a very awkward position in which it would have been impossible for it to avoid incurring the reproach of having broken faith. No doubt the proposal may now be regarded as dead, but it should be formally withdrawn

to clear the way for the negotiation of a reform of the existing wage arrangements, which are admitted by all parties to be unsatisfactory. In this negotiation it should be remembered that to pay individuals according to their individual output is reasonable, but to pay them according to the aggregate produce of an undetermined mass of natural resources, machinery, and labour is really quite out of the question. And there should be no hunting for some expedient to counter the universal tendency of mankind to "take things rather easier" when they are better off. After all, that tendency is sufficiently counteracted by the growth of new wants. We possibly do not work quite so hard as our primitive forefathers, but all the same reprehensible idleness is less common among us.

XII

BETTER BE A BANKRUPT THAN A FALSE COINER

[Part of a letter to a correspondent. I might have quoted Adam Smith, *Wealth of Nations*, Vol. II, pp. 415–16, ed. Cannan, in support of my position, see below, pp. 339–40.]

October 31, 1920.

DEAR MR. ——,

I think my greatest quarrel with you is on the comparative morality and economy of a State (1) making a frank composition with its creditors when it cannot pay them in full, and (2) pretending to pay them in full by giving them base money. I am sure the first is the more honest course, and I am much inclined to think it better from a purely economic point of view for the community as a whole. The second course cheats all other creditors as well as those of the State, and in the end causes greater confusion and disaster. The Germans have reduced their debt to about one-thirteenth of its gold value at the old par, and will reduce it much more before they've done with it, by depreciating the mark, but they would have done much better to suspend payment like an honest man that cannot pay his debts. I am not at all moved by the usual reflection that openly bankrupt States cannot borrow: it seems to me that it would make this world a very much better place to live in if not

a single State in it could borrow one penny : if they want wars and useless canals and other luxuries, let them raise the cost by taxation. There are good reasons for small localities borrowing, but countries are all big enough to be able to spread expenses evenly enough over time. Could anything be more contemptible than the way our Government used before the war to borrow money to put up an office in Whitehall ? I don't believe it is any use to cry out for equilibrium of budgets as a cure for the diarrhœa of paper : you may make your *budget* balance, but you will never get your actual revenue to cover your actual expenses till you stop the fall in the purchasing power of the money in which the revenue is raised. It would be cheaper to borrow 200 millions at 20 per cent. per annum than to raise the same sum by printing another 200 millions of Bradburies—in the long run. The stoppage of the fall in the purchasing power of money will be disagreeable in many ways, but so is the giving up of the practice of over-indulgence in intoxicating liquor.

XIII

SOME FALL OF PRICES IS DESIRABLE

[Part of a letter to a Member of Parliament, written in November, 1920.]

To persuade the Labour people that fall of prices is good for them is rather difficult. See the report on Prices and Cost of Living issued by their special committee. Mr. Dalton, there referred to, is a colleague of mine at the School of Economics, and we have often discussed the matter. During rising prices the working-classes lose because prices rise against them faster than their wages rise, but they gain by overtime and ease of getting employment : during falling prices they score by wages falling slower than prices, but lose by loss of overtime and more unemployment. Opinions differ which is best on the whole, and no doubt some classes of employment gain by the one and others by the other. What there's no doubt about is that all the people, workers and others, who lose by rising prices have had such a thundering bad time and the others such a good time that it is only fair things should be reversed for a bit, and the sooner the

better, since the longer the thing is postponed the less you make the actual gainers disgorge for the benefit of the actual losers. A sudden fall now will hit the people who have so far been battening on the high profits made by rising prices and will benefit the large numbers whose purchasing power has been enormously diminished. Twenty years hence it would only be another great injustice instead of a rough and partial rectification of injustice. There are still heaps of things which have not been adjusted to the new level of prices, e.g., the telephone, for which I am at present paying £5 for the first 300 calls and four-fifths of a penny each for about 150 more, total average per call about 3*d.*, and now they want to raise it to about double. . . . In spite of all unions and boards there are plenty of people about with very low manual labour wages still; they don't care to mention it too much for fear organized labour will come along and get them out of their jobs, but don't they hate railway men! I know one who lodged with a railway man and he wasn't allowed to come within a certain distance of the fire!

Argument is all in favour of a considerable fall—say such a fall as you would get by going to the gold par. I don't think there is much need to worry about the possibility of gold becoming so scarce as to bring prices back as far as pre-war level, which would be too far. The gold producers will take care of that: a lot of mines have been shut down for the present because gold has lost so much purchasing power, and if its purchasing power revives these will start again. Anyway, the advantage of getting stable international exchanges, which in practice can only be done by return to gold, is so enormous, as to be worth any possible risk of too great fall of prices. You may be able to frighten the business man with a suggestion that if we don't look sharp, the countries with worse currencies than ours will be back on a gold standard before us. When these currencies are quite played out and down to nothing, the people will begin to reckon in metal again—as the Mexicans have. The Germans can't get the mark back to the par of 5·6 grains of fine gold, but they could stabilize it at about 0·4 grains and have a stable exchange with America to-morrow if they chose. If we have given up hope of going back to the old par with gold, we had much better reduce the weight of the sovereign to that of 3½ dollars and abolish all restrictions on the export of gold to-

morrow: if that were done we should have a stable rate of exchange with America at once and without any difficulty the actual rate keeping as close to the new par of 3·50 as the rate used in pre-war times to keep to 4·86. Witte stabilized the rouble in that way, and there isn't the shadow of a doubt about the feasibility of the plan. If sovereigns and dollars can be exported and melted down into each other, it's quite impossible that an ounce of gold in dollars can differ in value from an ounce of gold in sovereigns beyond the small cost of making the transformation.

"Instead of which," you have just passed the second reading of a bill to make exportation permanently impossible without the leave of the executive Government.

The real difficulty about a fall of prices is the increased pressure of the national debt, and this was the great reason for having a capital levy and a war wealth tax to clear a great portion of it off before prices fall. Now, we have made our bed and must lie on it. Neither Germany, Italy or France can possibly support their debts at pre-war level of prices, nor I think even at gold par prices, which I expect to be higher than pre-war prices, so they must either compound openly with their creditors or pay in a depreciated currency. I don't feel sure what *we* can do: I think we *could* pay, but it will be a stiff business if we try, and more difficult if the foreign countries make a clean sweep of their debts.

I have got rather discursive, not knowing exactly what you want. If I can elucidate any part of the subject further, I shall be glad to do so. Lord D'Abernon was a tower of strength for sound currency and I miss him greatly.

1921

I

THE DIFFERENCE BETWEEN A BANK AND A CLOAK-ROOM

[An article published in the first number of *Economica*, January, 1921, under the title of "The Meaning of Bank Deposits." The argument is re-stated with less reference to passing controversy, in my *Money* (5th edition, pp. 79–83), but as the mystical school of banking theorists are still fond of expressing dissent from its doctrine, I include it here for reference. Before becoming entangled in the dispute, every one should see that he keeps firmly in his mind the two very obvious facts: (1) that the stock of coin and notes held by banks at any moment is the excess of the coin and notes which they have received from all sources over the coin and notes which they have parted with to all recipients, and (2) that the total of deposits is the sum of money which the banks' accounts show as owed by the banks to their depositors.]

I HOPE I am not succumbing to the fashion of supposing a golden age in the past, but I cannot help thinking that the nature and functions of deposit banking were much better understood forty years ago than they are now. We had not then become convinced that nothing in economics can be both simple and true, and the young were taught that the theory of deposit banking was very simple. The banker was a man or a collection of men who undertook to keep money safely for its owners until they wanted it, and who made the business pay by lending out a good deal of this money to other people who wanted temporary loans.

The *Political Dictionary* of 1845 says, "People may deposit small sums of money at a bank, which the banker lends. Thus a bank is a means of facilitating the loan of money from the possessor of money to the farmer or manufacturer who has goods but wants ready money. The lending of money is the operation of banking, and a bank is a centre which facilitates this lending;

it enables people to lend through a banker and his connection, who could not lend without that."

William Ellis, in his bright little *Outlines of Social Economy*, 1846, intended for school-children, says: "The Banker . . . receives and takes care of the money of his customers with the understanding that he is to be prepared to pay on demand whatever they may call for." He asks what inducement the banker has to go to this trouble, and answers that of the money "part is employed at interest by the banker, and the interest thereby earned not only suffices to pay all the expenses of the establishment, but yields in addition a surplus profit sufficient to induce the banker to persevere in his business."

Mrs. Fawcett, in *Political Economy for Beginners*, 1870, and Jevons, in his Primer, *Political Economy*, 1878, say just the same.

The conception was a perfectly simple one, and I think it was and remains a perfectly true one. There is nothing really mysterious about the nature of banking "deposits." The term "deposit" seems very appropriate as the name of the verb which we use to describe the action of placing an article with some person or institution for safe custody. We "put things down" anywhere—our spectacle-case and our gloves, and often fail to find them again, and to "deposit" a thing is etymologically nothing more than to put it down; but the latinity of the word seems to give it a tinge of solemnity suggestive of the rites we go through when we entrust our bag to the cloakroom clerk instead of "putting it down" on the platform.

With one exception we deposit things for safe custody with some person or institution in the full expectation of receiving again, when we come to claim it, the identical article which we deposited. We deposit our bag in the railway cloakroom on the distinct understanding that this bag and not merely an equally good bag will be restored to us when we demand it. True, if the railway company loses the bag owing to the inadvertence or dishonesty of its servant, it will tender compensation, and, the bag being irrecoverable, we shall have to accept fair compensation; but compensation implies that the contract has been broken: the contract was to restore the same bag and nothing else.

Moreover, with the same single exception, the things when deposited may not be used by the person to whose custody they

are entrusted. We should be seriously annoyed if we found the cloakroom attendant using our umbrella to keep himself dry in a shower of rain, and it would be wholly irregular for the wife of the chairman of a safe-deposit company to appear at a ball decked with the jewellery deposited by the Duchess of Blank. If the thing is to be used by the person to whom it is temporarily entrusted, it is not said to be deposited and to be " a deposit " : it is said to be " lent."

The one exception to both rules is money. Money is more homogeneous than bags and their contents. The substitution of one half-crown for another will not affect us in the same way as the substitution of even our dearest friend's toothbrush for our own. Consequently, if we have deposited a half-crown, we are content to receive back another half-crown, or even " half-a-crown " in the different shape of two shillings and a sixpenny piece. No one, except some very small child, expects to receive the identical money which he deposited. Consequently persons and institutions receiving money on deposit have almost invariably mixed up the amounts received from various depositors. Deposit your hat in the hotel cloakroom and the attendant will not expect you to be content to receive back the first hat he can lay hold of ; but deposit your money in the hotel office and you will only expect to get back " the sum " for which you hold a receipt, and it will probably be paid to you in cash deposited by other depositors, or even in cash received in payment of guests' accounts. The homogeneity of money has always stood in the way of any objection being raised by the depositors of money to their deposits being used by the persons to whom they are entrusted. If you happen to meet the hotel ostler riding the bicycle which you deposited with him, you recognize it and complain ; but if in a shop you are given in change a ten-shilling note which you deposited in the hotel office a few hours before, you probably do not recognize it, and if you do you will not dream of going to the hotel-keeper and asking him why he presumed to spend your ten shillings : he did not undertake to keep *that* ten shillings for you, and he has another ten-shilling note ready for you.

This explains why the depositor of money, unlike all other depositors, requires to pay nothing for the accommodation which he gets, but on the contrary nearly always receives something

either in incidental services or in interest over and above the advantage of having his money kept safely for him. You will pay ninepence for depositing two bags and a rug for a day or two, but you can deposit a million pounds for a good deal less than nothing.

There is nothing in this one difference between money and other goods to suggest that the person with whom money is deposited can lend out more than he possesses in his own right *plus* what is deposited with him. The most abandoned cloakroom attendant cannot lend out more umbrellas or bicycles than have been entrusted to him, and the most reckless banker cannot lend out more money than he has of his own *plus* what he has of other people's. This is true even of a note-issuing banker: such a banker will no doubt lend his promises to pay on demand so long as there are people who will take them in exchange for goods and refrain from presenting them for payment; but these people are in reality making him a loan without interest. The extent to which he can borrow in this way limits the extent of his lending.

If it were not true that a banker's power to lend is limited by what he owns and can borrow, we should have the extraordinary result that a small bank with small deposits could lend as much as a big one with many millions of deposits. Yet banks seem to regard it as of considerable importance to acquire depositors!

The nineteenth-century writers, taking it for granted that no one would suppose that a banker could lend more than he had got of his own and other people's, were in the habit of saying rather loosely that he could lend some proportion, such as two-thirds or three-quarters of what he had obtained from depositors. But away back about 1730 Cantillon (in a passage cribbed like much else of his, by Postlethwayt's *Dictionary* before his *Essai* was published) had explained quite clearly that the banker had to forecast incomings in the shape of deposits and repayments of advances and set them against his forecast of outgoings in the shape of withdrawals of deposits and advances which he would not like to refuse, and that different bankers dealt with different classes, so that what was sufficient for one might be wholly insufficient for another—one might require to keep in hand about a tenth of his deposits and another would not be safe with less than a half or two-thirds. And anyone can see that the proportion would vary from time to time with the same banker as well

as between banker and banker at the same time. If only a banker could arrange to make his incomings exactly correspond with his outgoings, he would obviously have no reason for keeping any stock or reserve at all.

It was never supposed by the simple-minded nineteenth-century economist that anyone would make a difficulty about the aggregate of deposits (1) exceeding the aggregate of cash held by the banks, or even (2) exceeding the aggregate of all the cash held by all persons and institutions, including the banks.

1. It was naturally supposed that a single banker could have a million of deposits and lend out, say, £750,000, that two bankers could have two millions and lend out £1,500,000, and the whole number of bankers together could have deposits equal to four times the amount of their cash in hand. No one saw any miracle in the aggregate of deposits being, say, a thousand millions when the cash held was only £250,000,000; this was looked on simply as another way of saying that the banks had lent out three-quarters of the money lent to (*alias* deposited with) them. No one supposed that they had "created" the £750,000,000. If cloakroom attendants managed to lend out exactly three-quarters of the bags entrusted to them, we should not be surprised to find that the number of bags on deposit was exactly four times the number in the cloakrooms: we certainly should not accuse the cloakroom attendants of having "created" the number of bags indicated by the excess of bags on deposit over bags in the cloakrooms.

2. Nor used any difficulty to be made if the aggregate of bank deposits was seen to exceed even the total of cash in existence. It is true that bags not being "currency," a means of payment or medium of exchange which passes easily from hand to hand, bags could only be lent on hire to borrowers who wish to use them personally, so that the number of bags on deposit would be less than the total in existence. But when the bags or other things deposited are currency, the situation is different. Borrowers in this case do not borrow with the intention of retaining the article borrowed till repayment, but with the intention, which they carry out immediately (simultaneously very often) of parting with it in exchange for other things. Consequently, though they owe the sum of money lent them, they do not hold currency to that amount. If you have borrowed a bag and not

yet returned it to its owner, you probably have it still: if you have borrowed a thousand pounds it is most unlikely that so much will be found on your person or in your drawer at home. Thus the amount of the currency does not limit the amount of money which can be lent whether by the banks to customers (borrowers) or to the banks by customers (depositors). If the total of bank deposits is three times as great as the total of coin and notes in existence we need no more suppose that the banks have "created money" to the extent of double the coin and notes than we need suppose that because the National Debt is ten times the amount of all the coin and notes, the State has "created money" to the extent of nine times the coin and notes. No ordinary lender supposes he creates money by lending it; why should the banks? Just as the amount of the State debt or the total of all individuals' debts is only the sum of what the State or the individuals owe, so the total of bank deposits is simply the sum of what the banks owe. In no case is there any reason for boggling over the fact that the totals greatly exceed the currency in existence.

All this is much too simple for the present age. Instead of the old doctrine that capacity to lend is based on the possession of valuable property, and that banks accordingly can lend out of their own capital *plus* what solvent customers lend to them (*alias* deposit with them), we have journalists and popular writers and chairmen of large joint-stock banks persuading the public that banks have themselves created, or to use Mr. Hartley Withers' own word, "manufactured," thousands of millions of pounds by lending something which did not before exist to borrowers, who proceed to pay it to other people, who in their turn deposit it in the banks, and who could not have so deposited it unless the banks had lent.

This curious inversion seems to be partly due to the practice of considering how large a proportion of his deposits a banker can safely lend in the form of a question what ratio his advances should bear to his cash. No doubt when you have a million of deposits to deal with, it comes to much the same thing whether you ask what ratio your cash should bear to your liabilities, or what ratio your advances should bear to your cash. But to compare the cash held by the banker with the amount lent by him without any reference to his aggregate command of money is

very apt to be misleading. When, for instance, Mr. Withers remarks (*Meaning of Money*, 1918 issue, p. 35), "A banker who has £10,000 in gold or notes at his command would be running too great a banking risk if he advanced ten millions to the most unexceptionable customers," he may have meant that a banker who had £10,010,000 at his command would be very foolish to lend out as much as ten millions and keep only ten thousand in cash. But it is likely that some one among his readers will rub his eyes and say, "Wonderful thing it is to be a banker! Now I have got £10 in my pocket, and yet nobody warns me not to lend £1,000 on the strength of it. Prudence be blowed! my trouble is that I cannot lend a penny beyond my £10 because I haven't got it. Anyone who borrows from me will want to take the money, but these banker fellows seem able to find borrowers who don't. Withers says on the next page that the banker who lent the ten millions to the unexceptionable customers 'would give them the right to take out ten millions in gold and notes, and if even a thousandth part of the right were exercised, the banker's gold and notes would be all gone.' Somehow or other the money lent by the banker seems to stay in his possession, so that he can 'lend' *ad lib.* provided he isn't asked to lend in gold or notes."

The error of this inference clearly arises from leaving out of sight the fundamental fact that the banker is able to lend X, Y and Z more than his own capital because A, B and C are allowing him the temporary use of some of theirs on condition that he will let them have what they want of it when they ask for it. The "customers" of a bank include both lenders to the bank and borrowers from it, and though some of them are borrowers to-day and lenders to-morrow, there are at any single moment two distinct classes, between which the banker is the intermediary who arranges for the capital of the lenders being used by the borrowers.

I do not think Mr. Withers anywhere denies that where there are a number of banks the power of each bank to lend is limited by the extent of its "resources"—its power, that is, to command money—nor that he anywhere asserts that it can directly increase its resources by lending. If it could, every little bank would soon be a big one; but he does seem to hold that all the banks in a particular country (what is a country?) taken together, and

any real or supposititious single isolated bank increase their power of lending by lending. The real inspiring text for this doctrine seems to have been the saying among bankers, "Loans make deposits." Indirectly, no doubt, it is true that the lending of money by bankers tends to make deposits, because it is a useful service to the community. Road-making, and any other useful service may similarly be said to tend to make deposits. This seems to be all that the phrase "loans make deposits" originally meant. A nineteenth-century banker, W. Haig Miller, remarks: "Bankers increase their deposits by lending money to individuals, who by their loans become wealthy and increase the resources of the district." (*On the Bank's Threshold*, 1890, p. 69.) But latterly the proposition, sometimes hardened into "every loan makes a deposit" (*Meaning of Money*, p. 63), has been taken to mean a good deal more than this.

In Mr. Withers' chapter V, on "The Manufacture of Money," the reader is asked to consider himself a "prudent person" who has borrowed £1,050 from his bank to pay for a new motor-car, and is assured that his "borrowing of £1,050 has increased the sum of banking deposits as a whole, by that amount."

If the borrower's £1,050 was lent him by his bank simultaneously with the repayment to the bank of £1,050 by some other borrower, the proposition would be indefensible on the face of it: if it were true that replacing one borrower by another increased deposits, the total would long ago have reached astronomical figures. Mr. Withers must mean us to suppose that the £1,050 was an *addition* to the loans already made by the bank. The theory thus is that every addition to the total of loans by banks makes an equal addition to the total of their deposits: and if there is only one bank, every addition to the total of its loans makes an equal addition to its deposits, for Mr. Withers later in the chapter introduces the supposition of an isolated district with a single bank which has, according to him, increased its deposits from £100,000 to £1,500,000 by lending £1,000,000 and investing (which is treated as a sort of lending) £400,000. The only other items in the balance-sheet are capital £100,000, and cash in hand £200,000.

Of course, a balance-sheet, as an expert in currency has observed, must balance; we must expect to find assets and liabilities growing up together at the same pace. The only ques-

tion is, " Did the amounts on each side rise, as the nineteenth and previous centuries believed, because monied persons had the power and the will to lend to (or 'deposit with') the bank, as time went on, more and more money, or, as Mr. Withers teaches, because, as time went on, the bank chose to lend more and more ? "

The only reason Mr. Withers gives for throwing over the old view that it is the action of the depositors in depositing which enables the bank to lend, and adopting the new view that it is the action of the bank in lending which enables the depositors to deposit, is that the isolated locality " could not have deposited £1,500,000 without advances from the bank, because there never was such a sum in the place." Presumably " there never was such a sum in the place " means " there never was £1,500,000 in coin (or possibly Bradburies) in existence in the place at one and the same moment." But what difficulty does this fact present ? No one supposes that the depositors paid in £1,500,000 at one and the same moment. Their £1,500,000 was got together by small surpluses of amounts paid in over amounts withdrawn, spread over a long period. If they paid in an aggregate of 1,326 sovereigns per business day and withdrew only 1,000, they would accumulate £1,500,000 to their credit in fifteen years, and the bank by keeping twenty-two of the sovereigns per day would add £100,000 to its cash, and by paying out the other 304 to borrowers would add £1,400,000 to its advances in the same period. The depositors have deposited £1,500,000 more than they have withdrawn, and it is difficult to make any sense at all of Mr. Withers' proposition that they have " presumably deposited £100,000, since the bank holds £200,000 in cash, of which £100,000 may be taken as having been contributed by the subscribers of its capital." The depositors have a well-founded belief that the whole of the deposits have been deposited by them : are not they the depositors ? but Mr. Withers tells them gently but firmly that they are quite mistaken ; they have only deposited one-fifteenth, and " the rest of the deposits have been provided by the bank itself." " The broad conclusion," he says a few pages further on (p. 72), " is that banking deposits come into being to a small extent by cash paid into banks across the counter, to a larger, but still comparatively small extent, by purchases of securities by the banks which create book credits, and chiefly

by means of loans from the banks which also create book credits."

It seems incredible that anyone should imagine that depositors cannot have paid in the past on balance more cash into their bank or banks than the amount of cash which the bank or banks possess at the present moment, but Mr. Withers does not stand alone. Mr. McKenna, in his speech to the London Joint City and Midland Bank shareholders in January, 1920, which was widely applauded, took just the same line. "In June, 1914," he said, "the banks held £75,000,000 of currency. Last month this figure stood at £191,000,000. The banks, therefore, held more currency to the amount of £116,000,000, and to this extent the increase in the aggregate of bank deposits is accounted for by payments in of currency."

The rest of the increase in the deposits, amounting to about £1,114,000,000, he attributed to "bank loans." We might have expected that the example of the Savings Bank would be sufficient to warn Mr. McKenna off the strange assumption that the amount of cash held by banks shows how much of their total deposits is accounted for by payments in of currency. It could scarcely be contended that any but a small proportion of the nineteenth-century Savings Bank deposits was not "accounted for by payments in of currency," but on December 31, 1899, the Post Office Savings Bank deposits amounted to £130,000,000, while the cash held against them was too trifling a sum to appear as a separate item in the Post Office accounts. In the previous nine years the total of deposits had risen by £62,500,000, of which £20,500,000 was accounted for by interest credited to the accounts by the Bank, and the remaining £42,000,000 was "accounted for" by the fact that the payments in by depositors, which must have been nearly all in currency handed across the counter, amounted to £280,000,000, while the withdrawals were only £238,000,000. Will anyone say that either the sixty millions or the forty millions were "created by the Savings Bank," or that they were "provided by the Bank itself," or that they should be "attributed to bank loans"?

It would seem well to return to the nineteenth-century doctrine that banks receive money from one set of people and lend it to another: that the total of this money at any moment is a total of the same nature as the total of the money lent on mortgage

of property: that it is just as wrong to regard it as a kind of fictitious cash "created by banks" as it would be to regard the money out on mortgage as a kind of fictitious cash created by solicitors, and little, if any, less wrong than to regard it as a mass of gold. We should also revive the doctrine that deposits tend to increase when people become more numerous and richer, and that given a certain population and material welfare, they tend to vary with variations in opinion about the comparative desirability of direct individual investment and indirect investment through the medium of banks (in more familiar language, opinion about the comparative advantage of "putting your money in the bank" and "putting it in business or stocks and shares"). Recent experience suggests one addition which the nineteenth century never required to think of. This is that the total of deposits tends to increase with a diminution in the purchasing power of the unit of currency in which they are reckoned (and of course *vice versa* it tends to diminish with a rise in the purchasing power of the unit). If the pound sterling will buy less, people of the same wealth and people dealing in the same amount of goods as before will require, and be able to have, a larger number of pounds at their banks than before. Hence the enormous rise of deposits in this country since the beginning of the War, and the much greater rise in countries in which the unit of account is still more depreciated.

II

FUNDAMENTALS IN REGARD TO WEALTH AND TAXATION

1.

[A review of Pigou's *Economics of Welfare*, 1920, in the *Economic Journal* for June, 1921.]

In presence of a book of a thousand pages a reviewer feels somewhat of a worm, but, like that despised being, he is inclined to turn when he finds that the author has incorporated an earlier book of his own comprising five hundred pages without troubling to make the usual statement explaining what parts are new and

what old, and also the general effect of the alterations and improvements, if any. Attempting to do for Professor Pigou what he ought to have done (and could have done better) himself, we may say roughly that Part I of *Wealth and Welfare*, on " Welfare and the National Dividend," reappears in the *Economics of Welfare* expanded by about 50 per cent. Part II, " The Magnitude of the National Dividend," becomes " The Magnitude of the National Dividend and the Distribution of Resources among Different Uses," and contains additional chapters suggested by the " controls " of the war period. Part III, " The Distribution of the National Dividend," is divided in the new book between Part V, which bears the old title, and a new Part III, on " The National Dividend and Labour." The author's increased interest in public finance bears fruit in the appearance of a wholly new Part IV, " The National Dividend and Government Finance," and the new book ends like the old with a Part on " The Variability of the National Dividend," *alias* booms and depressions. A good deal of the matter which was not in *Wealth and Welfare* is repeated from articles in the *Economic Journal* and other periodicals.

The sage who observed that of the making of books there is no end, was a child in these matters. In Professor Pigou's paradise each author will scrap his *magnum opus* by superseding it with another twice its size every eight years. Most of us will sigh for a little of Malthus' " prudential restraint." It would surely have been better to let *Wealth and Welfare* remain in its old form and to have supplemented it with entirely new books of more moderate dimensions.

Part I, as summarized by the author, looks at first sight easy enough. It argues, he says, " that the economic welfare of a community is likely to be greater (1) the larger is the *average* volume of the national dividend, (2) the larger is the *average* share of the national dividend that accrues to the poor, and (3) the less variable are the annual volume of the national dividend and the *annual* share that accrues to the poor." In the rude language of everyday life, a big, well-distributed and steady income is better than a small, ill-distributed and violently fluctuating income, especially if the fluctuations fall chiefly on the poor. Must we read 108 pages to make sure that we are right in believing this ? But having read them, I am tempted, in the

manner of Agrippa, to say unto Pigou, " Almost thou persuadest me not to be an economist," so prolific are they in suggestions of doubt and difficulty. What is this " National Dividend "? Marshall, when introducing the term into economic literature in 1890 (*Principles*, 1st edition, p. 560), understood by it " a certain net aggregate of commodities, material and immaterial, including services of all kinds," which constituted " the true net annual revenue of the country." Professor Pigou rashly says " the concept has nothing to do with the dividends paid by joint-stock companies," but it is quite clear that Marshall used the word " dividend " because he was thinking of the amount " to be divided," just as a board of directors does when it finds that the company's profits will provide a dividend of 10 per cent. on the capital. The name " national dividend " is, in fact, nothing but a synonym for the " net produce " of older writers and the " real income " of later writers, which may be sometimes appropriately used when distribution rather than production is under discussion.

Now it seems easy to believe that when the " net produce " or " real income " of a community grows (its numbers remaining the same) its economic welfare will grow. But how are we to speak quantitatively of the net produce? It consists, as Professor Pigou says, " of a number of objective services, some of which are rendered through commodities, while others are rendered direct " (p. 30). We cannot think the total of them as greater because it weighs more or occupies more cubic space. In fact we think of it as greater or less according as it is *worth* more or less. At first we measure its worth in pounds or francs, and then, if it is suggested that pounds or francs themselves are not worth the same as they were, we try to get over the difficulty by raising or lowering the number of pounds or francs in due proportion to their lower or higher purchasing power. If we were satisfied to reckon the purchasing power of money by its power to buy red winter wheat, or a bushel of red winter wheat plus a ton of pig-iron, or any other particular commodity or collection of commodities, that would end the matter, but we should only have substituted red winter wheat or the collection of commodities for money, and it might still be claimed that the wheat or the collection had altered in purchasing power. We are driven to inquire, what do we mean by " the same purchasing power "? I understand, perhaps wrongly, Professor Pigou to say that I

have the same purchasing power when I can buy the same amount of economic satisfaction (pp. 69–79). The result, apparently accepted by him on page 70, is that the total net produce must be regarded as greater or less according as greater or less economic satisfaction is derived from it. If this is so, I fail to see the use of an elaborate attempt to prove the first of the three propositions, viz., that "the economic welfare of a community is likely to be greater the larger is the average volume of the national dividend." It seems to become a truism.

The use of "national" as the adjectival form of "community" in the proposition calls up another difficulty—Professor Pigou's treatment of war in regard to the national dividend. His is a nationalist scheme of economics, as is suggested by the frequent use of "national" and "nation," and the occasional intrusion of "this country" or "England" into a discussion of a general character. Now in national economy soldiers, guns and forts play just the same part that policemen or private watchmen, revolver-makers and window-bar-makers play in individual economy. In adding up the incomes of individuals to arrive at the national income in the ordinary sense, we do not think of excluding the incomes of the policemen, the revolver-makers and the window-bar-makers: these persons render services which are included in "that objective counterpart of economic welfare which economists call the national dividend or national income." We do not exclude their incomes or the services rendered by them on the ground that if there were no house-breakers and assaulters we could very well do without them: if there were no diseases we could do without doctors. We do not exclude them on the ground that there is no real satisfaction in having, or, as we say, "having to have" a watchman: there is none in having to have a doctor, and some people are sorry that they have to have food. Now Professor Pigou expressly includes doctors' services in the national dividend (p. 72), and I can nowhere find any sign of his excluding the money-incomes of soldiers and munition-makers from the national money-income or the services rendered by these persons from the national dividend. When the vaunted "measuring rod of money" is applied, the services of the military officer with £1,000 a year count for as much as the services of the medical officer with the same salary. Accordingly I am puzzled when I find Professor Pigou talking (p. 18) about "the possible

conflict, long ago emphasized by Adam Smith, between opulence and defence," saying that the "dissatisfactions" resulting from lack of security against successful attack "lie outside the economic sphere," and arguing that "injury to economic welfare may need to be accepted for the sake of defensive strategy." If a workman, finding his temperature was 102°, chose to lose two days' wages at once rather than continue at work for those two days and be sick for the following three weeks, would we speak of him as "accepting injury to economic welfare for the sake of defensive strategy against influenza"? Of course not: we should say he was taking the economically prudent course. And so, it seems to me, an economist who looks on economics from the point of view of the nation—his own for choice—and who accepts the old "possessing exchange-value" criterion (re-christened something like "susceptibility to the measuring rod of money") for deciding what is to be included in the national dividend or objective counterpart of economic welfare, is bound to regard war as a productive trade, just like the manufacture of bread or patent medicines. A nationalist economist who does not hold to the exchange-value criterion is at liberty to pick and choose between war which promotes and war which does not promote economic welfare, just as he picks and chooses when he throws out the useless or pernicious patent medicines, and an economist who not only rejects that criterion, but also thinks of the community or society at large rather than of a particular territorial group, can put all war on the same level as burglary and other disorderly activities recognized by every one (except perhaps those who practise them) as being destructive instead of productive of economic welfare.

The obscurity which surrounds the conception of the national dividend is deepened by the last paragraph of the chapter, in which the attempt is made to relate it to the "money income accruing to the community," i.e., the national income in the ordinary sense of the sum of the incomes of the individuals (and perhaps the institutions) located in the national territory. An addition to the national dividend, we are told in a parenthesis, must, of course, be made for the value of income received from abroad: no doubt we are intended to supply "or a subtraction for income paid to abroad." It is rather curious to put so important a matter in a parenthesis and after a casual "of

course." Is it not important that the national dividend is not by any means exactly what the nation produces, nor even, as Adam Smith implied in his opening words, a portion of that produce plus what is purchased from outside with the remainder, but this quantity as increased or reduced by international payments other than those involved in such purchases? But more difficult matter follows. We are to exclude from the national income all that is "received by native creditors of the State in interest on loans that have been employed 'unproductively,' i.e., in such a way that they do not, as loans to buy railways would do, themselves 'produce' money with which to pay the interest on them." At this point the sceptical reader may well interject, "*Would* loans to buy railways produce money to pay interest?" But our author goes on, "This means that the income received as interest on War loan—or the income paid to the State to provide this interest—ought to be excluded. Nor is it possible to overthrow this conclusion by suggesting that the money spent on the war has really been 'productive' because it indirectly prevented invasion and the destruction of material capital that is now producing goods sold for money; for whatever product war expenditure may have been responsible for in this way is already counted in the income earned by the material capital." Surely this introduction of "productive" in the Local Government Board sense of "bringing in money" is quite misleading. Whether the money was borrowed for a purpose which yields some money revenue or not, makes no difference to the fact that interest paid by the private individual A to the private individual B makes A's income smaller and B's larger by the amount payable, and this is recognized in income-tax returns and everywhere else. What is necessary to teach about State and local debts is that, while it is tempting to apply the same principle by taking the "income" of the taxpayer, not as what it is usually taken to be, but that amount net after deduction of the amount due as interest to the State creditors, in fact the existence of taxes on commodities stands in the way of this easy solution. Such taxes diminish the purchasing power of the taxpayer, not by diminishing the amount of money which he can spend, but by diminishing the amount of commodities which he can buy with a given amount of money, and if or in so far as the taxes raised to pay the fundholder's interest are of this kind, no

deduction from income in the ordinary sense is required for the purpose which Professor Pigou has in view. If A, with £1,000 a year, pays £50 in income-tax, which is handed by the State to fundholders or old-age pensioners, it is true that he has only £950 to spend on commodities and services and pay away in other taxation to State and local authorities, but if, still with £1,000 a year, he pays £50 in taxes on his wine and tobacco, and that is handed to old-age pensioners or fundholders, it is quite wrong to say he has only £950 to spend and pay away in other taxation. He still has £1,000, and the goods and services (including those paid for by taxation taken as worth what he pays) which form his share of Professor Pigou's national dividend are worth that sum, so that the suggested deduction in order to make the national income correspond with the value of the national dividend must not be made. In comparing one income at one period with that at another period, the necessary adjustment will be made by allowing for changed purchasing power of money, but for getting the national income and the value of the dividend to agree at the same moment, no tinkering with the figures is required so far as the taxation is on commodities. As no one knows, or can possibly know, how far it is, the whole matter is much less easy than it looks.

The suggestion that fundholders' interest forms an improper addition to national income recurs in a footnote to page 626, where it is said that "strictly," taxpayers in estimating their income for income-tax "ought to be allowed to deduct that part of their tax payment which is needed to pay the fundholders." How the part falling on each individual taxpayer is to be settled, is not stated, and the note admits that "the rate of tax would have to be considerably increased," and then ends strangely with the proposition, "Incidentally, the burden would be shifted to some extent away from persons who pay taxes but hold no Government loans, on to the shoulders of large fundholders." Why? Assuming, as the author evidently does, that the interest is met entirely from income-tax, has he not forgotten that when, as in this country is the general rule, Government interest is subject to income-tax, the fundholder would gain by the deduction and lose by the rise of rate equal amounts, just like a taxpayer who had no Government funds: and where Government interest is not liable to tax he would not be affected at all?

This talk of taxes leads me to another case in which Professor Pigou seems to have overrated the simplicity of their effects. In the chapter on "Taxes on the Public Value of Land," he quotes with approval the New Zealand law, which, he says, takes what Marshall calls the "public value of land" to be the actual value (in the everyday business sense) of the land minus the cost of improvements effected by the owner, so that if two properties A and B, each now worth £1,000, have been created out of dismal swamps by the expenditure of £100 on A and £400 on B, the "public value" of A, which can be taxed without detriment to enterprise, will be £900, and of B it will be £600. He thinks that the nine-tenths of the value of A and the six-tenths of the value of B, "being due to public causes, cannot be made less by any action or abstention from action on the part of the owner," so that taxation of it is "completely 'unavoidable' and the expectation of it wholly innocuous, provided only that the technical difficulty of appropriate definition can be overcome." This appears to overlook completely that remuneration of the skill and foresight of the swamp-draining owner is part of the cost of swamp-draining. In the absence of taxation we may suppose that before the improvement the two swamps looked to the ignorant much alike, and were offered by existing owners for sale at £600 each. X being a clever man and knowing about swamps bought A, while Y, not nearly so acute, bought B. X spent £100 and made a profit of £300; Y spent £400 and made a profit of *nil*. Anything which tends to reduce the profits of swamp-draining will tend to discourage X and others from ventures in swamp-draining, and what *increasing* tax will not? A tax which is a fixed amount once for all, like the English Land-tax (strictly speaking only when all the land in the parish belongs to the same owner), will not discourage improvement, but any tax which becomes heavier when the value of the land rises by more than the out-of-pocket expenditure of the owner (or than that plus some *uniform* percentage on it for profit), must deter people from undertaking the business of adapting land for economic use. It was not a difficulty of definition which first hung up and finally disposed of the Lloyd George increment duty: the required tax may be shortly defined as "a tax on increasing value of land which will not discourage improvement." The trouble is that, like the famous black hat, this tax does not exist.

The increment duty was found to fall on "builders' profits," and it was promised that it should be amended so as to prevent this; but there was no way of doing it. Of course the duty might have been a necessary tax although it "discouraged improvement": all taxes discourage some form of expenditure, and those which discourage only bad forms of expenditure do not bring in enough money.

About this many, no doubt, will agree with Professor Pigou rather than with the present reviewer, but few will be found to accept the amazing paradox put forward on page 629 that an income-tax with an exemption for savings is "neutral as between saving and spending," while an ordinary income-tax "differentiates against saving." Under the ordinary income-tax, A and B, with £1,000 a year each, pay the same tax, say £200, which leaves them with £800 each to spend or save as they please. A saves £250 and B saves nothing—the revenue recks not of it. Surely this is neutrality? No, says Professor Pigou, because next year A will be drawing say 6 per cent. on his investment, and will then be taxed on the £15 of additional income (and thus only have £12 additional to spend or save), whereas B, having no additional income, will only pay the same as before. But how is this differentiation against savings? The position is just the same as it was the year before, except that A having £1,015, £203 is collected from him, and he is left with £812 to spend or save as he pleases. On the other hand, when exemption is given to savings, supposing the £400 is still raised from A and B together, A in the first year is likely to save £260, pay only £170 in tax and spend £570, while B will pay £230 in tax and have only £770 to spend. A's position is then obviously improved in comparison with B's, not only as against a time when there is a uniform income-tax, but also as against a time when there is no tax at all. Possibly the confusion is explained by Professor Pigou's peculiar way of reckoning savings. He says, "If £100 of income is put away for saving," a uniform income-tax at x per cent. "removes £x from it at the moment," i.e., when, the tax being at 6*s*., Professor Pigou "saves £70" in the ordinary sense, he says he has "put away £100 of income for saving," thus including in his savings £30 which was collected from him by the Government, and which he had therefore no opportunity of either saving or spending. In actual life we save

and spend out of what the Government leaves us after we have paid out our income-tax.

In its general drift the book is in accordance with the tendency of common opinion at the present time. Thirty years ago a common saying was that enough had been done about production —it was time to turn to distribution. Now a certain reaction against that rather foolish cry is in full swing, and it is being recognized that in estimating the merits of principles and machinery of distribution we must always keep production before our eyes. Professor Pigou, like others, is subject to the influence —the result perhaps of experience rather than of mere academic intellectual activity—and this book is more reactionary (in quite a good sense of the word) than *Wealth and Welfare.* There is in it a more complete recognition of the fact that "problems of wages" which were once supposed to be adequately dealt with under "distribution" are questions of the organization of production. An obvious indication of this is the way in which "Labour Problems" have been taken out of the old Part III., on Distribution, but the change permeates the whole book and gives it "more bite" than the earlier one. It would have been better if it had been an entirely new book, and we may hope that moulds have been kept of it, so that when it is sold out its author may not be tempted to incorporate it in a two-thousand page *Welfare and Economics.* Anyway, it is a valiant effort by a very gallant gentleman to increase our economic welfare.

2.

[A review of Sir Josiah Stamp's *Fundamental Principles of Taxation in the Light of Modern Developments*, 1921, in the *Economic Journal* for September, 1921.]

THIS book consists of the Newmarch Lectures at University College, London, for 1919. In Early Victorian times it would have been entitled simply "Lectures on Taxation," and perhaps the vaguer title would have been more accurate. Sir Josiah Stamp is always interesting and instructive, but it is not given to him or any man to throw the light of modern developments on the fundamental principles of taxation very effectively in six lectures. I confess to some doubt about the meaning he attaches to "fundamental principles." I suspect that nine-tenths of his

audience went away with the impression that he was taking Adam Smith's four canons (who invented that phrase? Smith calls them "maxims") as his text, and suggesting additions called for by modern experience. But the four canons are scarcely to be regarded in any sense as fundamental principles. As any careful reader of Dr. Robert Jones' *Nature and First Principle of Taxation* knows, they are only four selected out of the larger aggregate number put forward by various writers whose works Smith had read, and it may well be doubted whether the selection was not as much the result of imperfect memory as of deliberate choice. Bastable, in the first edition of *Public Finance* nearly thirty years ago, put the Smithian maxims into a mere appendix, though he subsequently relented and admitted them to the text. Since then the whole subject has been simplified by the invention of the doctrine which Sir Josiah quite unjustifiably calls "Marshall's doctrine of least aggregate sacrifice." Sir Henry Parnell may have "anticipated" this doctrine, and Professor Carver, whom Edgeworth quotes, may have suggested it, but its first definite enunciation is, I think, to be found in Edgeworth's article in this *Journal* for December, 1897, where he says, "*Minimum sacrifice*, the direct emanation of pure utilitarianism, is the sovereign principle of taxation." It is curious that Edgeworth, the supposed embodiment of the unpractical, should have been the promulgator of this glorified common-sense and eminently practical principle, but it must be admitted that, perhaps misled by his own reputation, he embedded it in articles of an uninviting appearance on "The Pure Theory of Taxation," and treated it as if it required us to put the incomes of a year on what Dr. Jones calls a Procrustean bed, and to forget that next year no incomes will be found longer than the bed. It was soon seen that minimum sacrifice need not mean minimum sacrifice for such a very short run as that of a single income-tax collection (see Edgeworth himself in the *Memoranda* of the Royal Commission on Local Taxation, published in 1899, and the present reviewer on "Equity and Economy in Taxation," *Economic Journal*, December, 1901, and *History of Local Rates*, 2nd edition, 1912). Minimum aggregate sacrifice in the long run is the principle which all good ministers of finance and parliaments endeavour to the best of their abilities (often poor) to adopt. Under its ample folds, equity, ability, benefit and all the

other good things drop into their proper places, and no place is found for that slogan of the barbarian adult and the civilized child, *fiat justitia ruat cœlum.* Civilized adults will not give an unlimited price for equity. Marshall, always alive to the progress of thought, adopted the doctrine in *After the War Problems* in 1917. How Sir Josiah Stamp has inadvertently misled his readers in this matter is illustrated by the fact that one of his reviewers (B. M. in the *Statistical Journal*, May, 1921) says approvingly that he "criticizes Professor Marshall's 'aggregate sacrifice' theory as leading to pure confiscation of income at certain levels," the fact being that the "Procrustean bed," so far from being constructed by Sir Josiah Stamp to kill the theory, had served at its birth twenty-four years earlier.

Our author intends, he tells us, "to outline the questions of principle which are raised by modern developments in taxation or are made obvious by the intensity of the burden, and to view them under a new arrangement." Under the new arrangement we look at them first from the point of view of the taxpayer, then from that of the State, and lastly from that of the "community as a producing or Economic Society." This seems very much like another way of saying that the three fundamental principles of taxation are Equity, Productiveness, and Economy, the last of these terms being of course used not in the petty sense of cheapness of collection (as on page 93 of the book) but in the wide sense in which satisfying economy means serving the permanent economic interest of the people—the sense in which Adam Smith tried to explain his fourth maxim. The new method is expected to enable us to treat modern problems "with that isolation of effects and freedom from distraction which are so necessary to a clear conception of essentials," but it is no more productive of clean cuts than the old. Smith admitted that "after all the proper subjects of taxation have been exhausted, if the exigencies of the State still continue to require new taxes, they must be imposed upon improper ones" (*Wealth of Nations*, Vol. II, p. 390, repeated in almost the same words, p. 414), and modern writers admit that a large quantity of enonomy must outweigh a small quantity of equity, and *vice versa.* Just so Sir Josiah Stamp has to admit that compromise between the three standpoints is necessary. (We need not hold him too literally to his statement that "Most taxes in practice

represent the best practical compromise between the three standpoints that can be arranged in the particular circumstances of the time," which rather suggests the tax-surveyor or the Royal Commissioner on the Income-tax whose recommendations have been adopted). The new arrangement seems in practice even less successful in keeping different considerations apart than the old. While looking at things from the individual standpoint, we are asked to consider the doctrine of taxing rents or surpluses, the principal recommendation of which is to most of its advocates its supposed absence of discouragement to production, and we are also asked to deal with "Progression justified as an engine of social improvement." While taking the State's point of view, we are to consider the possibility of certain taxes promoting dishonesty or producing a tariff war. Though the taxation of alcoholic liquors according to alcoholic content—a matter which concerns individual drinkers of alcohol as among themselves—is dealt with from the standpoint of the individual, the very heavy and productive taxation of alcoholic liquors as a whole, which touches the individual drinker and the individual teetotaller acutely, only comes up when we get to the standpoint of the community.

The general trend of recent developments, Sir Josiah holds, is everywhere towards personal taxation of income becoming more predominant in national taxation while at the same time it loses ground in local taxation. He is doubtless correct in this, but he might perhaps have pried a little further into the future. Are there no signs that as communications grow national income-taxes will break down in the future as local income-taxes have done in the past? The States of the North American Union are treading the path which English parishes trod in the eighteenth century, and the States of Europe and America are likely to have gone the whole way before the end of the twenty-first, if not earlier. The growing arrangements for meeting the "difficulty of double taxation" are the thin end of the wedge of a virtually international income-tax which is likely to precede the abandonment of complete independence by the States.

Income-taxation will continue to be progressive, but on the question how steep the progression will or should be, our author throws little light. He seems to have cut off the possibility of doing so by considering it mainly from the individual standpoint.

"It is very difficult," he says, "for a man to say quantitatively that one boot pinches *three* times as much as the other, even where both are his own, and how much more difficult is it for one man to say that his boot pinches twice as much as another's!" Quite so, but the remark suggests that we had better give up "standpoints" and go back to the old "maxim" method, and say that Equity really furnishes no guide of any permanence (compare opinion at the time of Harcourt's budget with that of the present time), and that the steepness of progression must be decided by the maxim of Economy. We shall never decide whether to put a penny on beer or to further steepen the super-tax on incomes by considering how much the loss of a penny pinches the beer-drinker and the duke: we shall, and we do, decide it by making some rough estimate of the aggregate advantage in the long run of the two methods to society at large. For example, if we find that cheaper beer means better food for underfed children while less super-tax means more training of horses to run fast for a short distance with a very light burden, we incline to the super-tax: but if we find cheaper beer means more beer for drunkards and less super-tax means more houses for the people to inhabit in comfort and health, we incline to the beer tax. Whether we use the phrase or not, we are following the principle of least aggregate sacrifice.

If Sir Josiah had found salvation in the comfortable doctrine of least aggregate sacrifice he would, I think, have told us some things which we would be the better for knowing. No one is better qualified than he to tell us whether the recent enormous aggravation of progressive direct taxation has actually brought about (as well as merely tended to bring about) an important redistribution of net (i.e., after deduction of taxes) income, and whether, if so, the redistribution is likely, either for a time or permanently, to cause an important diminution in the supply of fresh capital. He quotes Mr. W. H. Mallock to show that a levy on capital which caused greater equality of wealth would be likely to diminish savings. But surely the essence of a capital levy is not the redistribution of the total of net incomes but the liquidation of debts on which individuals pay interest (collected by the tax-gatherer) to themselves and each other. Any little difference which a capital levy might incidentally make would, we may safely say, be a trifle compared to the redis-

tribution which has already been made by the new taxation and which would be simply maintained by the levy. It is no doubt extremely tiresome to have to remember that £500 a year nowadays means about £450, while £1,000 a year means about £800, and £20,000 a year means little over £10,000 after income-tax and super-tax have been taken out and before any provision for death-duties is thought of. But we find it necessary to have the smaller figures before us in real life, and we shall have to treat them and not the gross figures as more nearly indicating the distribution of economic goods.

III

DEFLATION MAKING PROGRESS: GOOD EFFECT OF BILLS BY TENDER INSTEAD OF BILLS ON TAP

[A Memorandum, dated August 21, 1921, circulated in confidence to a few friends. Early in the War the usual practice of offering a certain amount of Treasury Bills to be tendered for, i.e., allotted to the highest bidders, was abandoned in favour of what was called putting the bills "on tap," i.e., offering an indefinite amount at a price fixed by the Treasury, and this practice continued till April, 1921.]

I HAVE no desire to stir the muddy waters of Currency at present. The various harmful bacteria seem to be eating each other up at a great rate, and I do not want to interfere with the process. But privately I reflect as follows:

Last Christmas, when we had just seen that the Cunliffe limit would not be appreciably less for 1921 and 1922 than it was for 1920, I should have thought it very sanguine of anyone to prophesy that in less than 8 months the total of Currency Notes and certificates would be down by 44 million, the Bank Note issue in the same period being down by 8 million. I may have asked for a reduction of more than 6½ million a month but I certainly did not expect to get so much.

If I had an abounding belief in the power of single individuals to influence the course of events and a positively overflowing conceit, I should attribute the surprising reduction to my efforts, in *Money* and other works and especially in a speech made to the Sound Currency Association on January 25, 1921, to convince

the world that those who issue paper currencies, and they alone, can control the amount issued. In fact, I think what has happened has been due to the Government being able to borrow at a somewhat cheaper rate than before, and being consequently more willing to borrow at interest instead of relying on non-interest-bearing paper currency. I begin to wonder whether reluctance to pay what is at the moment considered a very high rate of interest on debt is not usually the real cause of issues of inconvertible paper money. It is usually said that a Government issues the paper because it *cannot* borrow. But does not this only mean that it is not willing to pay sufficiently high interest? Has any modern Government ever offered 20 per cent.? Or even 15? Why not? Simply because rather than pay so much it prefers to succumb to the temptation of issuing a forced loan at 0 per cent. by printing legal tenders. So when interest rises violently, there is a tendency to issue inconvertible paper, and when it falls a tendency to limit and withdraw it.

In our own case at present I think considerable importance should be attributed to the resumption of the tender system in issuing Treasury Bills. Under the fixed-price system the Treasury gets as much as the market is willing to lend at that price; under the tender system it gets just as much as it asks for at the price which the market is willing to lend that amount. The immediate correspondence of what comes in with what is actually wanted is consequently much closer under the tender system. Under the fixed-price system worked by a Treasury desirous of making the best bargain possible for the State, it must constantly have happened that the price fixed was not quite high enough to bring in the required amount, and the difference would then be made up by the issue, through the Bank, of additional Currency Notes. Under the tender system, no such accidental increase of the Currency Notes outstanding can arise from miscalculation of the possibilities of the money market. Increases can only arise from miscalculations of receipts and expenditure over short periods or from deliberate intention. Miscalculations of receipts and expenditure are not likely to be important, and will be likely to balance each other, so that the regulation of the issue is more obviously and continuously a matter of deliberate intention.

A comparison of the chart of outstanding notes for 1921 with

that for 1920 suggests that the resumption of the tender system has actually made a great difference. Down to the time when it took place, the lines take a very similar course, probably explainable by the seasonal balance of receipts and expenditure: since the resumption at the end of April the lines diverge sharply, that for 1920 going violently upward to August 4, while that for 1921 goes almost steadily downwards for the corresponding period, with a trifling exception at the beginning of August. In August the downward direction of both agrees again. It certainly looks as if the Treasury were convinced of the desirability of a reduction and were deliberately effecting it.

I do not want anything more. I do not want a public declaration by the Treasury that they are reducing the issue and will continue to reduce it till the value of a £1 note is the same as that of 113 grains of fine gold in a free market. That would cause an opposition to the policy which at present does not exist simply because the policy is undeclared and unrealized by the people who would object to it if they knew of it. Besides, and this is more important, a public announcement, if it were believed in, would cause an immense financial disturbance. If a sufficient number of persons believed that the £1 note would be worth 4·87 dollars in a year or two, it would have to go up with a bang now at least 50 cents. (The present value of 4·87 two years hence, discount at 7 per cent. per annum, is about 4·25.)

Of course it is rather disappointing that the 8 months' reduction has not caused an actual improvement in the dollar exchange and the price of gold. But I think this is quite properly explained as largely due to the Federal Reserve Board's policy of opposing a "new gold inflation," which practically means that it is making the U.S. buy up gold in the same way as it used to buy up silver under the Sherman Act. This is keeping the value of gold up just as the Sherman policy kept the value of silver up. When it breaks down, as it will, we shall have a sudden fall in the purchasing power of gold and dollars which will lessen the gap between the actual exchange and bring the pound sterling far towards 4·87. It may perhaps happen that this will be prevented by a coincident return of some country now denuded of gold to a gold currency, but this does not seem very likely in the immediate future.

IV

WHAT THE WAR-BOND HOLDER CAN JUSTLY CLAIM

[Part of a letter to a Member of Parliament, October 20, 1921.]

It is scarcely true that the public creditor only expected to get bad paper when he lent during the war. The British one was always told that the Bradbury wasn't depreciated at all, and if he wasn't fool enough to believe that, he still had no good reason for expecting that Government would water the currency worse for a year after the war than it had watered it during the war. The German and Austrian national creditors were much worse treated: the mark during the war, if I remember right, retained about a third of its gold value. The German bondholder would no doubt be glad now to receive 33 per cent. of what is due if it were paid in gold marks, but your suggestion is that he should be content with about 3 per cent. This isn't a reasonable composition.

And if a Government can't pay, is that really a good reason for robbing all pre-war owners of fixed annual payments? All property is founded on legitimate expectations, and it certainly was a legitimate expectation that the Parliament of the U.K. would not debase the pound sterling: the people who ought to suffer are those who thought it would. Still I'm not a believer in *fiat justitia ruat cœlum*, and if you could give me a $4 pound to-morrow and guarantee its sticking at that level and continuing convertible into gold meltable and exportable I would accept the offer. But you can't; nobody can. There is greater safety in going for the old $4·8663 pound.

V

THE DEFLATION OF 1815–21: COMPARISON WITH THE PRESENT

[A letter to Professor Charles Rist in answer to an inquiry about the currency history of the period following the Napoleonic War.]

November 30, 1921.

Dear Professor Rist,—

I am not quite sure whether you wrote your letter with my book, *The Paper Pound of* 1797–1821, before you or not. On the

historical details I am afraid I can add nothing to that work, but if you want the figures in the tables continued beyond 1821, where they stop, I could easily get them for you.

On the main question you ask, whether there was a policy of deflation, I would say this. The Bank itself had no policy of any kind: it did not want to change the existing situation. When it was told that the situation must be changed, and that it must begin to think about performing the promise which it made on every bank-note to pay "pounds," which every one understood to be gold coins of a certain weight and fineness, it imagined that the way to do this was to accumulate gold coin, even if it had to buy the gold with more bank-notes. (A century later plenty of people think the value of an inconvertible paper currency is, or at any rate should be, governed by the percentage of metal stored away to "cover" it.) Ricardo and his school very properly said that the only way to bring the depreciated notes up to par was for the Bank to reduce their quantity by getting them in gradually from its debtors and not reissuing so many in new loans. The Bank's plan was tried and failed, and then Ricardo's was tried and succeeded immediately.

Of course the Bank had a very powerful debtor—the State, and if that debtor had refused to pay off any of his debts, the Bank, as I say in the *Paper Pound*, could scarcely have reduced the notes sufficiently. But the Government was honest and solvent and readily did what was required.

One thing which differentiates that time from the present is that the Bank was much freer than the modern State banks, and lent a much larger proportion of its paper money to its private customers and less to the Government. It was more culpable than the banks of to-day and the Government was less culpable than the Governments of to-day.

Another thing is that people of that time knew nothing of the stupid modern doctrine which confounds bankers' debts with currency. Bankers' debts are no more currency than any other person's debts. If we want to raise the value of a currency, we must cut down the magnitude of the currency itself and refuse to be diverted by tales that something else ought to be attacked. I enclose an article which I wrote recently on this subject and which remains unanswered. [No. I of 1921, above, pp. 256–66].

In this country there is a third great difference in the fact that

the notes which have done the mischief in our time are not bank-notes lent to the State and others by a bank, but Currency Notes issued directly by the Treasury and not (except a few in 1914 soon repaid) lent at all to private customers. The State gets the profit of them directly instead of by the roundabout method of allowing a bank to issue and then borrowing from it and then extracting the profit from the bank, as your and most other governments do. But this does not seem to make our people see things any clearer.

VI

THE DETERMINATION OF THE RATE OF INTEREST

[A lecture given to the Staff of the Bank of England in the Bank Court Room, December 16, 1921.]

NOT long ago, I am told, a party were discussing great inventions and asking each other which was the greatest. They thought of fire and the alphabet and the decimal system, and what not, and then an American farmer came out with—

"The man who invented interest was no slouch."

That man was prehistoric, and we are not likely to discover his name. Interest is now a very old thing. In the earliest times of which we have any historical record interest was very unpopular. The Jewish law, attributed to Moses, and certainly of great antiquity, no matter at what date it was codified, forbade Jews to take interest from Jews, though they might take it from foreigners. Aristotle, in the third century B.C., said it was justly the most hated of all unnatural methods of getting money. It was unnatural, he thought, because the nature or purpose of money was to be used to buy and sell with, not to be used for, so to speak, breeding more money. The Greeks called interest τοκος, which means offspring, and Aristotle explains that the name came into use because money at interest seemed to breed money. Careless readers have long alleged that he thought interest unnatural because money is naturally barren, but this is a misunderstanding. The great Churchmen of the Middle Ages quoted Aristotle and a very doubtful passage in the Gospel of St. Luke, and invented all sorts of recondite justifications of the

popular prejudice against interest. They said that if money or any consumable goods were lent to, and then replaced by the borrower, it must be swindling to charge something more—it was charging for something which wasn't really given: as an alternative they suggested that it was charging for time, which the lender had no right to charge for, as it did not belong to him but to God.

Many reasons may be suggested as contributing to the old popular hatred of charges for the *use* of money—*usury*, as it was called. One is that people who borrowed usually borrowed merely because they were in great straits, while the money-lender was wealthy: another that money-lenders charged exorbitantly, and were cruel to their debtors and so on. But I have no doubt that the root of the whole thing was the belief that the lender was getting something for nothing. There is a passage in Exodus, ch. xxii, which shows that it was regarded as quite legitimate to charge for the use of a horse, and you never find in the Middle Ages or elsewhere any objection to charges for the use of durable goods which are lent to the borrower under a contract which provides for their eventual return—the return of their identical selves—to the lender. In the case of such loans it is easily seen that the lender is not normally charging for something which costs him nothing, since he is forgoing the use which he might himself have made of the things lent. But if a person who has a hoard of money or a stock of sacks of grain lends £100 on condition that the borrower shall pay him £2 a month as well as repay the £100 when required, or lends 100 sacks of corn on condition that the borrower shall pay 2 sacks a month as well as return 100 equally good sacks when required, the borrower, in a less commercialized atmosphere than ours, does not see that the lender parts with anything in exchange for the £2 or 2 sacks per month. He thinks "What good would it have been to old Shylock to have gone on keeping his money in his chest instead of lending it to me?" or "What good would it have done that farmer to keep his corn in his granary instead of lending it to me? The rats would have had some of it, whereas I have to give him back 100 full sacks, so he would have benefited by the loan, even if he had not got the 2 sacks a month."

It was sure to be seen, as time went on and commercialism grew, that the lender of money and consumable goods did forgo

something. Perception of the fact is commemorated by the substitution of the word "interest," the etymology of which implies the existence of "something between," for the old word "usury," which suggested a "use" of money or consumable goods which current doctrine declared not to exist. It began to be admitted that the lender might find something between, a difference between his position if the debtor did not repay at the proper time and his position if he did, and it was held that a charge for this difference, or "interest," might justly be made. This admission was bound to undermine the whole doctrine, because when it was once allowed that the lender might be worse off in consequence of not getting his money back, it could not be denied that he might be worse off in consequence of lending it out in the first place. Very soon it became a commonplace to argue that when a man lent his money, he gave up to the borrower the opportunities he might otherwise have used himself: he might have bought stock in trade or instruments and made a profit by them to which no one would have objected. A reasonable charge for the loss of these opportunities or payment for what was between, "interest," came to be regarded as perfectly legitimate, and legislation only aimed at suppressing the higher charges, which retained the old name of "usury."

Prohibitions of charges for loans of money having thus been succeeded by limitations, discussions arose about the propriety of altering the exact limitations fixed upon, and this inevitably started inquiries into the causes which made the market price for loans—the rate of interest charged—high or low, and also into the question of what are the effects of high or low rates. Towards the end of the seventeenth century Sir Josiah Child started a brisk controversy on the subject. He had a very poor opinion of the laws of England, and described them as "a heap of nonsense compiled by a few ignorant country gentlemen who hardly knew how to make laws for the good government of their own families, much less for the regulation of companies and foreign commerce." But this did not prevent him from invoking their assistance to bring down the rate of interest. The maximum rate which was then allowed was 6 per cent., and he wanted it reduced to 4 or even 3, and alleged that every possible good economic result would follow. Naturally he found opponents, and the dispute largely turned on a comparison of England with Holland,

where the rate of interest was lower. It was successfully argued against him that he had inverted cause and effect, and that instead of Holland being rich because the rate of interest was low there, the rate was low there because Holland was rich. Here we have a theory of the cause of rise and fall of interest—interest is lowered by the increase of riches, by which, of course, accumulated goods were meant. The theory, however, was hampered for some time by the prevailing tendency of the period to substitute money, or gold and silver, for the whole of the goods. It became common to attribute the fall which had taken place since the end of the Middle Ages to the increase of gold and silver money which followed the discovery of the Western Hemisphere and its prolific mines. The increase had quite obviously raised prices, that is, it had lowered the value in the sense of the purchasing power of money, and it was rather stupidly supposed that if the value of money in that sense was reduced, the rate of interest, which was thought of as the annual value of money, must also be reduced. It was overlooked that while the value in the sense of the purchasing power of money is measured by the quantity of commodities other than money which it will buy, the annual value of money in the sense of the rate of interest is measured in money *itself*. The fact that £100 will only buy what £50 used to buy is doubtless a reason for giving only half as much of other commodities and services for the use of £100 for a year as was given before the change, but to secure that only half as much shall really be given it is not necessary to reduce *the number of pounds* sterling given for the use of £100 at all. If the rate was 5 per cent. before, it can continue 5 per cent. and yet it will only mean half the old quantity of goods and services: if the £100 will only buy what £50 did before surely the £5 will only buy what £2 10*s*. did before.

In the middle of the eighteenth century the acuter thinkers broke away from this fallacy, and it soon became a very firmly established and generally accepted doctrine that not the increase of money, but the increase of the stock of accumulated goods, or capital, as it came to be called, tended to reduce the rate of interest. It was also more clearly seen that the rate of interest in the narrower sense of the term, i.e., the rate charged by lenders and paid by borrowers, is only part of a larger whole, the rate of return upon capital, whether owned by persons who use it them-

selves or by others. But to the question WHY increase of capital should cause the rate of return to fall, no satisfactory answer was given for a century. The belief of the reigning school of economists was that the return was a residue of the produce left to the capitalist after he had paid out the earnings of the workers, and that this residue became smaller when capital increased, because a larger share had then to be paid to the workers. The objections to this doctrine are numerous, and many of them are obvious. Among them we may select as most important (1) that though in each individual transaction or business it is usual for the capitalist's share to be the residue, what this share is going to be on the average is settled by the economic conditions just as early as what the earnings of work are going to be—in short, the capitalists' share is not any more what is left after the workers' share is taken out than the workers' share is what is left after the capitalists' share is taken out, and (2) in the progress of civilization the produce per worker, or productiveness of industry, has steadily increased, but instead of this having been accompanied by a steady increase of the rate of interest, as the doctrine requires, the rate has fallen greatly since more primitive times.

Within living memory a much better explanation of the effect of increasing capital has been evolved. You are asked to remember that at any given moment an enormous number of different possibilities exist for the investment of savings, or which is the same thing under another name, new capital. At the present moment, for example, new savings may be invested in, i.e., take the form of, additional apparatus for agriculture, for manufacture, for transport, or for housing: and each of these provinces is divided into innumerable districts, e.g., agricultural apparatus, may be horses or tractors, drains or irrigating canals, and so on, and may be here or in Canada or in India. If you take any one of the small subdivisions separately, you can see that the return to investment in it will fall rapidly if more and more capital is put into it. Why? Obviously because the most profitable opportunities will be taken first, and they are limited: when you put a small amount of savings into irrigation you only irrigate the lands which will benefit most: when you put more in, you have to irrigate some lands where the return is not so large, and so on. Finding the return to irrigation getting less, you leave off that and try something else, not so profitable as the most profitable irrigation

but more profitable than the less profitable down to which you were being driven. Then the same thing happens in this new field of investment: you find here, too, that you are being driven down to the less profitable things. It becomes plain that the more new capital there is the lower the rate of return with which you must perforce be content. It does not matter in the least what form of society you have: if you had an absolutely communistic society, there would still be a "yield" or return on that society's savings, though it would be more difficult to reckon it in percentages, and this return would still tend to be less when the material equipment of society grew larger. The acuteness of the need for capital in a primitive poor society may be illustrated by the traveller Fraser's story of a scene in the far north-eastern corner of Asia. He found a household weeping and tearing their hair and apparently in most desperate grief. "What's the matter?" he inquired. "Is somebody dead?" "Somebody dead!" they replied contemptuously. "What is death? *We have* LOST THE NEEDLE!" Where the accumulation of tools and instruments was so small that there was only one needle, you can well imagine that additions to it would bring in a very high return.

But the magnitude of the capital is not the only thing subject to change. The number of the people to use it may increase or diminish. The more people there are able and willing to work, the greater will the return tend to be. This truth is not much more than the converse of that with which we have just been dealing, since you must think of capital and population in relation to one another, and it is much the same whether you talk of capital becoming greater in proportion to population or of population becoming smaller in proportion to capital. But there is no harm in approaching the subject first from one side and then from the other, so we may ask ourselves what will be the effect of increase of population if the capital remains stationary. Obviously, it will tend to raise the return on capital. You can see why easily enough if you think of the pleasure which the owners of the factories and machinery used in the manufacture of things which go to make up a cotton shirt feel when the number of the people to wear cotton shirts increases: or of the sorrow with which the shareholders in Argentine railways and tramways would feel if the population of Argentina was heavily reduced by a plague. Increase of population obviously benefits the owners

of existing capital, and almost as obviously tends to raise or keep up the return on additions to that capital, which is the rate of interest. If the unfortunate event which I have suggested were really to happen in Argentina, clearly no new capital would find profitable openings in that country for some time, and the return all the world over would be kept down by this shrinking of the field. All the world over, I say, because we must remember that neither population nor capital are shut up in water-tight national compartments. Some people would like them to be, and certain legislatures put considerable difficulties in the way of their movement, but they do move pretty freely all the same, and on the whole, more and more freely.

Next we have to notice that the comparative increase of capital and population is not the only thing to be thought of. The return obtainable on new capital will also be affected by changes in people's knowledge of ways of doing things. One side of this has been seen for a long time. It is pretty obvious that from time to time new profitable machines are invented, and that very often, at any rate, the new ones are more elaborate and costly than the old. Take roads for instance. People used to know no better than to drag their heavy goods in horsed carts over gravel roads, uphill and down, only altering the more excessive of the natural gradients. Then an inventor appeared and assured them that a steam engine with smooth wheels could be made to pull trucks and carriages fast and easily on smooth iron rails, provided only that the road was kept nearly flat. Forthwith a new and profitable investment for new capital was provided in making these railways with their cuttings and embankments and tunnels, and this absorbed a very large part of the savings of the world for more than half a century, and checked the fall of the return to new capital, and consequently of interest, which would otherwise have occurred owing to other profitable outlets being more used up.

But it was overlooked till recently that invention is not all of this type. Some kinds on the contrary suggest the use of more effectual but less elaborate and costly machinery, or even show us how to do without some part of existing machinery. Discoveries in chemistry are often of this character. You may have, for instance, an elaborate method of sewage disposal necessitating a great deal of pumping machinery, the use of a great area of carefully irrigated land and so on—then some chemist shows

you how to deal with the stuff in a much simpler way which only requires a tank or two. This kind of invention is always going on. It is equally important with the other, and only less obvious because it leaves no outward and visible sign of its presence. Somebody shows you an elaborate contrivance, a mass of wheels and pulleys, for effecting some purpose, and you think, "Wonderful invention!": it may be thrown on the scrapheap before long because somebody has invented some simpler plan which dispenses with all that elaboration, and you won't be taken to see it while still on the scrapheap, and the new process will not be at all impressive. You may walk by the side of miles of double posts carrying sixty heavy telegraph wires and think "Wonderful invention!" but when Marconi flashes messages through the air over your head you know nothing of it. All the same, this kind of invention is just as important as the other.

When you think of these great contending forces, increase of capital struggling against increase of population, and the invention of elaborate machinery struggling against the invention of simplificatory devices, and remember that the first of these two struggles may be going one way while the second is going the other way, you will not find it extraordinary that the rate of interest is as stable as it is, whether you think of thousands of years or of the few years which you have known. In the thousands of years over which history extends, it has certainly fallen, but not really very much in the last 400 or 500 years. In my own lifetime it has fluctuated a good deal, but it has never been down to 2 nor up to 12 per cent. per annum.

Moreover, it is rather more stable than it looks, for some of the highest and lowest rates only look as high and as low as they do because they are reckoned in a measure which is itself getting shorter or longer.

If you were making a loan in potatoes and were to be paid interest and principal in potatoes, and you knew that potatoes were going to rise in value before the interest and repayment of principal were due, you would see that five sacks of potatoes in interest on each 100 lent would be a much better bargain for you than if potatoes were going to fall: and the borrower would see that it would be a much worse bargain for him. The borrower might say, "See here, I don't like this. I shall be borrowing 100 sacks, worth, say, £100, and pay you after a year five sacks,

which by that time will be worth £5 2*s*. 6*d*., and still owe you 100 sacks, which will then be worth £102 10*s*. If you don't mind I'd rather borrow £100 at 5 per cent." If I insisted on making the loan in potatoes and having the interest in potatoes, and the real rate of interest was 5 per cent., you would insist, and I should have to give in to your insistence, that I should reduce the rate to 2·44 per cent. in sacks of potatoes. Then I should be in the same position as if I had lent you £100 of money at 5 per cent. in money. I should part with what was worth £100, and have at the end of the period what was worth £102 10*s*., and also the interest, 2·44 sacks of potatoes worth £2 10*s*. You, too, would be in the same position as if you had borrowed money at 5 per cent.

Now suppose it isn't potatoes which vary in value but money. If I know that the purchasing power of money is going to rise, and you know, we shall feel the force of just the same arguments. Five per cent. interest is a better bargain for the lender and a worse one for the borrower if money is rising in purchasing power than if it is falling. If it is rising 2½ per cent. per annum, you will get from me what will buy 100 units of commodities and services and have to pay me what will buy 5⅛ as well as owing me or repaying me the capital, which will now buy 102½ units of commodities. We shall end by bargaining for a lower rate.

It follows from this that when money is rising in purchasing power, in other words when prices are falling, the rate of interest nominally paid does not show the whole of what the investor is really getting; and when money is losing its purchasing power, i.e., when prices are rising, the nominal rate of interest represents the investor as getting more than he really is. For example, investors were not doing so badly as the interest rate taken by itself would suggest at the end of the nineteenth century, nor so well as it would suggest during the war: and they are doing rather better than it suggests at the present moment.

Has this explanation of the causes of high and low interest, the economists' explanation as it may be called, covered all the ground, or must we have some special theory, or a modified theory for the rate charged in the modern money market?

Some people think this money market rate is governed in a very arbitrary way, but they do not all agree who has this arbitrary power. Some attribute it to the Government. They gird at the Chancellor of the Exchequer for paying too much

interest, and say that his doing so causes a rise all round. But it is really too absurd to suppose that the rate is thus fixed by the Minister. If he really regulated the rate, he would borrow at one, or a thousandth part of one, per cent. He often fails to borrow because he has not offered good enough terms: and if occasionally he offers terms which are too good, we know very well that the lucky people who seized them quickly get the benefit, and that the general market rate remains as before.

Others imagine that the bank or banks which declare the most prominent rate by that action settle the rate for the whole money market.

Recently certain people were continually talking as if the Bank of England Directors could declare a rate of 2 or 20 per cent. just as they could order this room to be repainted red or green, and that the other banks and the money market generally would find no difficulty in conforming to their decision. This, again, is quite absurd. The money market rate is only a part of the whole, and may be above or below the general rate just as the rate obtainable on loans for any particular purpose may be above or below the general rate, but it is no more arbitrarily regulated by the will of a few persons than any other rate.

Remember the truth that was found out 300 or 400 years ago, that people are able and willing to pay interest on a loan of money because they can buy other things with the money lent. Nobody would pay interest if he was obliged to sit on the whole of the cash for the whole duration of the loan. Banks and similar institutions are no exception to the rule. They can only pay interest and provide for various services rendered to their customers, which is a kind of disguised interest, because they lend most of the money entrusted to them to others, who buy commodities and services with the money. They act as *intermediaries* between the persons who for the moment want to keep a reserve which they can draw on quickly and without loss and the persons who for the moment want to buy more things or pay for more services than they can manage from their own funds. The numerous reserves of the first class are made much more available by being pooled by the banks, since their owners do not want to draw on them all at once. All except a small portion can therefore be lent out by the banks.

Suppose the central bank, if there is one, and the banks and money market generally were arbitrarily to raise the rate of

interest (including the disguised interest in services) paid to those who entrust money to them to 10 per cent., and raise the rate charged by them for loans to 12 per cent. what do you think would happen ? Isn't it pretty obvious that they would very soon find themselves losing heavily, because they would have encouraged people to leave money with them so much and discouraged people borrowing from them so much that they would not be able to earn the amount necessary to pay the interest ? And, on the other hand, if they arbitrarily cut the interest they pay down to 1 per cent. and the interest they charge to 4 or 5 per cent., is it not pretty obvious that they would be in equal trouble, because now, though there would be plenty of would-be borrowers, there would be very little for the banks to lend ?

Some high authorities who ought to know better, think of the total sum of money to which the resources of banks and suchlike institutions add up as a kind of substance which can be watered or aerated by banks so as to be greater or less, but is not increasable or decreasable at the will of the persons from whom the banks derive it. They say, therefore, that if you take your money out of one bank you can only put it into another or pay it to somebody else who will pay it in again. Therefore the customers cannot reduce the quantity banks have to lend. This, of course, is absolute nonsense. Suppose I have £500 on deposit at a bank at 3 per cent., and I meet my friend Smith and he says he has a loan from the bank of £500 at 7 per cent., and wouldn't I like to lend him that sum at 5 per cent., and I say "All right," and I take the money off deposit and give him a cheque for £500, with which he at once pays off his loan from the bank, what then ? Obviously a direct loan from me to Smith has been substituted for an indirect loan from me to Smith made through the bank, and the bank's deposits and loans are both reduced by £500. A million similar transactions would reduce the aggregate by £500,000,000.

The fact is that the banks' powers are small. If they enter on the path which leads to insolvency, doubtless they can do a good deal of mischief. But so long as they serve their own interests prudently, they are bound, like anyone else, by the conditions of the market, and have no arbitrary powers of fixing the rate of interest.

Some may think that this is true when there is a sound currency

limited in amount by the cost of obtaining gold to add to it or in some more direct way, but that it ceases to be true when paper money can be manufactured without the limits imposed by convertibility or specific legal limitation. The belief arises in this way. If any of you were given the power by law of printing as many legal tender notes as you pleased, no doubt if you had no conscience about robbing other people, you would gaily print enormous quantities and buy all sorts of property, commodities and services with them. This is what gold producers do: they dig up the gold and buy bread and meat and houses in Park Lane and machinery for getting out still more gold: they don't *lend* it much: they *pay it away* for what they want. This, of course, tends to raise prices, and, as I suggested just now, the rise of prices, when recognized as continuous, tends to raise the rate of interest as commonly reckoned, while leaving what may be called the true interest alone. But banks are looked upon as lenders rather than spenders, and consequently it is imagined that paper money issued by banks is all issued by way of loan. This is not true, since banks pay dividends to their proprietors, and these are spent just like the dividends of a gold-mining company. Even this highly respectable Bank, when it enjoyed for a period after 1797 the power of issuing unlimited inconvertible paper money, could not refrain from paying increased dividends, and that, too, although it always had before it a probable early loss of the power and a reimposition of the obligation to pay gold. Supposing, however, that the bank of issue *could* only issue the notes by way of loan, it certainly seems as if the issue would be effectually limited by a sufficiently high rate of interest being charged on loans by the issuing bank. Fifty per cent., you may say, might be charged, and then no solvent person would borrow from the bank and no notes would be issued. If there were no Government borrowing, the argument seems sound enough. But, unfortunately, in recent years the various Governments have been enormous borrowers, and this quite alters the position. No bank in the world with the power of issuing inconvertible legal tender notes can keep down the amount which its Government insists on borrowing from it by charging that Government a high rate of interest. In the first place, the Government will refuse to pay a high rate and yet will insist on having the loan: in the second place, it does not make the smallest difference

whether the rate paid is high, low, or nothing at all, because in one way or another the Government will recover from the bank the profits made on the issue. Imagine the Bank of France, or the Reichsbank, or the Austrian State bank, refusing to lend to their Governments at less than 20 per cent., and try to discover what difference it would make if the Governments acquiesced and paid the 20 per cent.! In this country there has been no excuse for putting forward the theory of control by rate of interest, since the Currency Notes are not even nominally issued by a bank and then lent to Government: the Treasury issues them and lends them to itself, the rate at which it lends being obviously of no importance whatever, as the interest is a payment from one pocket into the same pocket.

So far from high interest keeping down paper issues, universal experience points the other way. The higher the rate at which it will have to borrow, the greater is the temptation to a Government to cheat its people by paying for such goods and services as it buys inside the country with paper money which is printed for the purpose, and costs nothing but the cost of printing and paper. I cannot remember any Government paying 12 per cent. for a loan: every Government which has been in such straits as that has succumbed to the temptation to pay in non-interest-bearing paper. I say "non-interest-bearing paper," not an "interest-free loan," because when you ask for a loan without interest from a friend you, at any rate, promise to pay at some time or other, but a Government or bank issuing inconvertible legal tender does not promise anything except perhaps to give you a new clean note for an old dirty one. Even the Tudor "benevolences" were better things, for they only took out of the pockets of the unfortunates who were made to pay them as much as went into the tax-collector's bag, but paper-money issuers besides taking from the people whose money-incomes do not move (or only move slowly) when prices rise, all that reaches the Government, transfer a large amount from these people to others whose incomes move quickly when prices rise, and then try to divert the hostility of the injured people from themselves to what they call the "profiteer" whom they have created, and from whom they now feebly try to get some of the profits back.

The conclusion is that the Bank of England and other banks should not try to govern the rate of interest. They cannot do

it, and will only do harm by trying; the proper course for them is to declare the rate which best suits banking interests. This will be the rate which also best suits the general interest. They should not be moved by any clamour of the people who want to borrow cheap on the one hand nor of the fewer but more ingenious persons who have persuaded themselves that high bank rates keep down prices. To do the Bank of England Directors justice they have not lately shown much sign of pandering to either set—more honour to them!

VII

"DON'T GROUSE!"

[A response to the request of the Editor of the *Financial News* for a message suitable to the Christmas and New Year season.]

I AM tired of all this grousing. To those who complain that we are ruined while Germany is brimming over with prosperity, I say, "What a pity it is that we won the war! If only we could have managed to lose it, the mark might have been worth about 20 cents and the pound sterling about 10 cents and the Berlin exchange have been 50 pfennigs to £1, and we should enjoy the enormous advantage of a depreciated exchange. The Central Powers would be clamouring for reparations, so that we should enjoy the inestimable privilege of sending out great quantities of goods without the disagreeable necessity of receiving anything in return. Our burden of taxation would be light because the depreciation of our currency would have reduced the internal debt to the equivalent of about 130 million gold pounds, and because we should still be paying the expenses of Government largely by printing more and more money. Altogether, how much happier should we be!"

Anyone who did not know that a great depression would follow the war has only himself to thank. All economists worthy of the name knew that this was the teaching of experience, and said so. This depression will pass, as others have passed before it, and it will pass quickly as soon as people reconcile themselves to the fact that the Great War of 1914 to 1918 ought never to have been expected to enrich the world.

1922

I

WHAT LEVEL OF PRICES SHOULD BE AIMED AT? AND SOME HISTORICAL QUESTIONS

[A review-article in the *Economic Journal* for March 1, 1922, on E. R. A. Seligman, *Currency Inflation and Public Debts*; Gustav Cassel, *The World's Monetary Problems: Two Memoranda*; and J. H. Clapham, C. W. Guillebaud, F. Lavington, and D. H. Robertson, *Monetary Policy: being the Report of a Sub-committee on Currency and the Gold Standard.* All of 1921.

The lack of information complained of in the first paragraph has since been largely supplied by E. L. Hargreaves' *Restoring Currency Standards*, 1926.]

PROFESSOR SELIGMAN's sketch covers the United States, France, Great Britain, Italy, Russia, Austria, Spain, South America and Japan. It leads him to conclude that public debts are due to war, that the issue of inconvertible paper always ends in depreciation, that the rapid rise of prices caused by large issues of such paper create an illusory prosperity followed by painful disillusionment, that the only ways of escape are (1) reduction of public debt either by (*a*) redemption or (*b*) repudiation, and (2) contraction of currency or stabilization at a lower level, and lastly, that public debts and currency have become international problems. For getting rid of her present troubles, he says, Europe must have the co-operation of the United States. In the historical sketch he fails, like nearly all historians in this province—Mr. Hawtrey is a recent and honourable exception—to explain what happens to contracts expressed in money when the monetary unit in which people reckon is suddenly made much more valuable. We all know what happens when the unit depreciates or appreciates without losing its identity, but who knows what happened when, for example, the American issues known as Continental were "redeemed in new bills at the rate of 40 to 1" in 1780? Did persons who had contracted a week

before, a month before, and a year before to pay 1,000 each have to pay 1,000 dollars in the new currency, or could they all get off by paying 25 dollars in the new currency, that being equivalent to 1,000 in the superseded? Or take the recent and interesting case of Mexico, which is not dealt with by Professor Seligman: when the Mexicans gave up paper pesoes as hopeless, and without any Government action suddenly took to reckoning in gold pesoes, did the sponge pass over all contracts, or how were they acquitted? Mr. Hawtrey has told us how in 1797 France and in 1809 Austria arranged for a scale of payments varying with the extent of the depreciation prevailing at the time when the contract was made, but the question whether such an arrangement is possible under modern conditions is always ignored in discussions about the desirability of returning to the old metallic units.

Professor Cassel's first Memorandum, written for the Brussels International Financial Conference, was completed in June, 1920, and first published in Volume V of the Proceedings of that Conference. The second Memorandum was written for the Financial Committee of the League of Nations for its meeting in September, 1921; in the Foreword, dated "October," the words "not hitherto published in any form" are used, but it was printed in the *Manchester Guardian Commercial* on October 27.

The first Memorandum has become so well known that it is not necessary to say much about it here. It remains the most brilliant and useful contribution to monetary literature made since the outbreak of the Great War. It has helped enormously the very considerable return to sound thinking and sound action which has taken place since the date of its publication. The second Memorandum does not seem quite so successful. Professor Cassel, while strongly opposed to any inflation being allowed to occur, has always been inclined to acquiesce in the results of any which has actually taken place. This attitude, which made him perhaps a more effective preacher against further inflation by suggesting that his views were moderate, ranged him on the side of the inflationists as soon as the fall of prices set in. He seems to underrate the advantages of returning to the old level of prices, while greatly overrating both the probability of prices falling to that level and the probability of their falling gradually below that level after getting down to it.

To treat a return to a level of prices which existed eight years ago, and from which the maximum departure was two years ago, almost as if it were exactly the same thing as an equivalent fall of prices from a level which had been stable for a century is surely very misleading. In this country and others like it hundreds of millions of fixed sums in money are still being paid annually under contracts made before the War, and these sums are very largely still paid by and to the same persons. Moreover, the ideas of the people about what is a proper price for commodities and services have by no means altogether accommodated themselves to the higher level of prices. Anything under ten years should be reckoned a " short period " in monetary history, and if we are to acquiesce in every inflation which takes place in less time than that, we certainly shall not get stability in the long run. For some compromise between complete acquiescence in the new level and complete return to the old, no doubt there is much to be said when the old level has receded more than three or four years into the past.

In fact at the present time a return to their old gold pars seems to offer a very suitable compromise, at any rate for the countries which have the least depreciated currencies, and when writing his first Memorandum, Professor Cassel was prepared to grant this, though even then he was somewhat oppressed by the fear that prices reckoned in gold might be too low and might go on falling unless all countries took great care not to demand gold either for circulation or reserves. Before September, 1921, however, he became much more alarmed by the rise in the value of gold which had then taken place, and which he puts as high as 75 per cent. in the twelve months. (He says on p. 122 that gold had " lost in some few years perhaps more than 60 per cent. of its pre-war value, and then in one single year recovered something like half this loss," i.e., the value fell from 100 to 40 and then went up to 70: from 40 to 70 is a rise of 75 per cent.). This instability of gold he found very shocking, and we are almost tempted to say that the instability of gold infected the stability of his views. The United States, under the guidance of the Federal Reserve Board, becomes a bogy which is set up in the way of those who wish to tread the path which leads to stable money and exchanges. " International relations and the actual situation of the gold market being such as here outlined, it seems

to be almost a practical impossibility for any European country, acting alone, to restore a gold standard, even at a reduced parity. This is clear enough so far as the smaller countries are concerned." If such a country by itself attempted to restore convertibility of paper into gold, says Professor Cassel, " it might quite easily see its whole gold fund suddenly exported to satisfy foreign demands for gold." This is just the kind of thing which used to be said by financial writers who would have liked to see Professor Cassel's head on a charger. Prudent bankers manage to avoid positions in which they will have to meet inconvenient demands whether from domestic or foreign creditors; and even if a country's whole gold fund was exported (in exchange for commodities or in payment of obligations), it is certainly not very obvious how its position would be worse than when, as at present, its whole gold fund is locked up in cellars and serves no useful purpose whatsoever—in fact it would be better, since some useful commodities would have been bought or some obligations discharged by the export. Now, towards the end of January, 1922, six months after Professor Cassel wrote, the small country of Switzerland has restored her currency to the old gold standard and kept it there for more than a month, and it seems perfectly possible, and on the whole probable, that, with or without free gold markets, Holland and Sweden, two other small countries, may join her before Great Britain comes in with Australia and South Africa in her train and Canada in front of her.

Another of Professor Cassel's propositions which it is even more impossible to accept is that the specification of the Reparations payments in gold must have the important and disastrous effect of raising the value of gold. None of the Governments which are hoping to receive these payments will refuse to receive them in their own currency, and all that the specification of gold means is that the quantity of that currency which they are to receive will vary with the varying gold value of the unit of that currency. " A milliard of gold francs " means to the Frenchman two milliard francs when the franc is worth half its old gold value, and means four milliards when the franc is worth only a quarter. To say that reckoning in gold must raise the value of gold seems to be much like saying that the value of gold must have been greatly raised by the rupee having been on a gold basis from 1897 to 1914, since it caused all payments

in India to be reckoned in a rupee equal to one-fifteenth of a sovereign.

When we ask to what practical conclusion Professor Cassel is leading us, we find that he wants us to believe that co-operation between the different countries is an absolute essential for a solution of the present monetary difficulties, and that the first step is " to refer the whole problem "—*parturiunt montes*—" to a small committee of experts." A better conclusion, attaching a modern tail to an old proverb, is that Heaven helps those who help themselves and hang committees.

Which leads us by a natural and easy transition to the consideration of the third of the little books of which the titles head this notice. The Sub-Committee responsible for it was appointed by the British Association's Committee on the " Effects of the War on Credit, Currency, Finance and the Foreign Exchanges," and consisted of Dr. Clapham and Messrs. C. W. Guillebaud, F. Lavington and D. H. Robertson. It reported to Section F at Edinburgh last September, but the Section, which had not had any opportunity of reading the Report, declined to be committed by it, so that it has been published, as the title-page says, by the individual members of the Sub-Committee. The Section's caution was prudent, but there is nothing very dangerous in the Report.

Part I, by Dr. Clapham and Mr. Guillebaud, brings together the British statistics for banking currency, national debt, foreign trade and prices in a way which makes them as little repulsive as possible to the average man. I doubt, however, if the banking figures can be explained without more inside knowledge than the authors possess. They ignore altogether the " Special deposit " system under which the Bank of England collected large sums from the other banks and handed them to the Government without putting them into " Other deposits " and " Government securities " in its weekly return, though the Government put them into " Ways and Means Advances from the Bank of England," thus appearing to borrow from the Bank money which the Bank had not lent—a thing suggestive of certain Divorce Court decisions. Whether the plan was adopted merely to prevent the Bank of England's reserve percentage looking so small as it would otherwise have done, or for some other reason, or whether it simply grew up in consequence of some accident, has

never been explained. Nor has it been stated under what head these amounts appeared (or rather were concealed) in the other banks' accounts. But the enormous drop of "Money at call and short notice" from £275·6 million at the end of 1918 to £150·6 million at the end of 1919, accompanied as it was by an increase of £89·5 million in "Cash in hand and at Bank of England," certainly suggests that it was classified as money at call or short notice, since it was in 1919 that the system was abandoned. The Report can only suggest that the drop was "probably due in the main to the extra demands made by Industry, and to the credits extended to customers to buy Funding Stock." It is characteristic of the somewhat airy manner of the authors that they do not ask from whom the £125 million was withdrawn.

On page 23 silver is mistakenly included as "cover" which is reckoned in calculating the limit of the fiduciary issue of Currency Notes, and it is misleading to say, "In order to maintain this limit, Bank of England notes were transferred from the Bank's reserve to the currency note redemption account as further increases were made in the currency note issue." There is no ground for believing that if the £19,450,000 bank-notes were not locked up in the Currency Note vault they would be in the Bank of England reserve: it is much more likely that they would all be in the "active circulation." To say that they were "transferred from the Bank's reserve" disguises altogether the true nature of one of the oddest of post-war monetary transactions—the issue of £19,450,000 in notes for £1 and 10*s*. (and in certificates entitling the holders to such notes) in order to acquire and hold, or at any rate with the result of acquiring and holding, £19,450,000 of bank-notes for £5 and upwards. The only thing which could justify such a transaction would be some change which caused banks and individuals to want to hold more small notes in proportion to large ones, and there is no reason for supposing any such change in the months of 1920 during which most of the transaction was carried out. In the absence of such a change it is clear that as it was possible for the Treasury to acquire and store up £19½ million in large notes, it could, if it had chosen, have adopted instead the simple and more economical course of issuing £19½ million less of the small notes. Happily, whether owing to a change of men or of mind, the absurd policy

of paying out Currency Notes and buying in bank-notes with them has long been abandoned, though it is still perhaps too much to hope that its memory may soon be blotted out by the Treasury sending in the bank-notes to the Bank to be cashed in gold, adding the gold to the £28½ million of gold at present held, doing away with a stupid double reckoning which unnecessarily increases the apparent total amount of the paper currency, and dispensing with a line in the weekly Currency Note Account.

The current topsy-turvy doctrine represents banks as getting more deposits the more they lend, instead of *vice versa*, but it is surely carrying this unusually far when the authors of Part I attribute the "maintenance of a very high level of deposits" partly to "the large amount of long-term credits to foreign firms which the exceptional conditions of the period made it impossible to call in." Lend largely to foreigners who can't pay you back, and your deposits will grow!

The section on Foreign Exchanges and the Balance of Trade smells somewhat of mercantilism.

In Part II Mr. Lavington aims at answering "the fundamental question: What price level is now desirable in the general interests of the community?" i.e., the people of the United Kingdom, but adds a gloss, "Would it be higher or lower than the post-war level, and by how much?" which involves him in a wholly unnecessary and confusing investigation of the question, "What *is* the normal post-war level?"

The post-war level is, the reader will at once object, likely to be affected by action adopted in consequence of views held about what it ought to be. A thorough inflationist policy on the part of the Government and legislature, acquiesced in by the people, could raise the price level in this country to the dizzy heights attained in Russia and Austria, and a thorough deflationist policy could similarly bring it back easily to gold level, and with a little difficulty to a still lower level. Why then does Mr. Lavington ask whether the desirable level is higher or lower than *the* post-war level? The other collaborators in the Report seem to have scented a difficulty and tried to meet it on page 8 by substituting "that post-war level which, in the absence of deliberate action, may be expected to establish itself" (cp. p. 66, bottom). Are we back in the middle of the eighteenth century, hankering

after the rule of Nature? We are reminded of Quesnay's motto:

> *Ex naturâ, jus, ordo, leges,*
> *Ex homine, arbitrium, regimen et coercitio.*

But did Nature prescribe the Bank Charter Act of 1844? or the Currency and Bank Notes Act, 1914, which gives the Treasury power to issue unlimited amounts of Currency Notes and to authorize the Bank to issue unlimited amounts of bank-notes? or the Gold and Silver (Export Control, etc.) Act, 1920, which virtually annuls the convertibility of the Bank and Currency notes? or the Treasury Minute of 15th December, 1919, in which "directions" are given to the Bank, as the agent of the Treasury, to limit the issue of Currency Notes in such manner that the fiduciary portion shall never exceed the maximum attained in the preceding calendar year? Perhaps it will be answered that the maintenance of the existing law and regulations is deliberate inaction rather than "deliberate action." But this will not do. The one thing on which all schools are agreed is that even within the present law and regulations, the action of the Government affects the purchasing power of money. The Treasury cannot avoid deciding every week whether it will arrange for meeting its expenditure by the aid of an increase of notes issued or in spite of a decrease of notes. In the course of a year it has redeemed £50 million of notes, giving its subjects in exchange £50 million of interest-bearing securities. Can anyone say that is not "deliberate action," or that prices are not affected by it?

However, the post-war level is put by Mr. Lavington at 240 per cent. on *The Times* index number. He arrives at this figure by regarding the top, 329, reached in April, 1920, and what he seems to have thought the bottom, 189, in April, 1921, as both abnormal, and then splitting the difference, but supporting the guess by an estimate of "purchasing power" existing at the moment of writing, without, apparently, asking whether this, too, might not be abnormal. He then discusses the advantages and disadvantages of a higher or lower level fairly enough, but without arriving at any positive conclusion whether it would be better to aim at something different from 240.

In Part III Mr. Robertson argues very sensibly in favour of the restoration of the gold standard as a "respectable interim

measure " pending the evolution of some better standard. He justly rejects the policy of reducing the amount of gold in the sovereign " except as a last resort," in case of dire necessity. He deprecates any attempt to bring down prices further, but recommends sharp resistance to the rise which may be expected at the end of the depression, and hopes that this may put the level of prices here on an equality with the gold prices of the countries already on a gold standard, and so bring us back to the old parity by a method actually advantageous in itself, as it involves use of the one real prophylactic against depressions, the damping down of the preceding boom.

II

GOLD FOR CURRENCY OR ONLY FOR STANDARD ?

[A letter to Professor Charles Rist. His " address on Banks " was given at a public conference held at the Conservatoire des Arts et Métiers on February 28, and was printed in the *Revue d'Économie Politique*, No. 2 of 1921, under the title *Les banques d'émission et l'après-guerre.*

The estimate in the third paragraph " not more than £30,000,000 " seems unnecessarily liberal.]

April 3, 1922.

DEAR PROFESSOR RIST,—

Many thanks for the second copy of your address on Banks. I feel rather doubtful about page 178. I do not think any one country by itself will avoid much trouble by confining the convertibility of paper into gold at the old rate to persons wanting gold for export. You cannot undertake to give gold for paper at the old rate to exporters until you have brought the paper franc up to the value of the gold franc, and abstention from giving out gold for internal circulation or for use in the arts of dentistry, watchmaking, etc., will not make this appreciably easier, since France would only make a small addition to the demand for gold, and so whether she uses gold internally or not will not much affect the value of gold in the world market. The horrors of deflation will be scarcely alleviated.

Moreover, I doubt if there is more than a very trifling gain if *all* the civilized countries do the same. They are so infatuated with

the delusion that enormous reserves of gold are necessary to maintain convertibility, even for foreign trade purposes only, that those which have got large hoards at present are not likely to think that they can give up any part of them if they abandon the idea of restoring internal convertibility.

I don't think the demand for actual circulation among the people is likely to be large. In this country it used to be said that the Englishman liked gold in his pocket, but that was mere twaddle: the Englishman kept gold in his pocket because the law would not allow him to have bank-notes under £5, and when he got outside that law in Scotland, Ireland and the British colonies, he took to paper just like other people. I never heard anyone propose that we should go back to the old law on this matter, and as for the probable practice, it is true that we hear women (who have no pockets) say they will be glad to get back to gold, but men always say they will stick to notes. My belief is that not more than £30,000,000 will be required to satisfy our internal demand and we can easily spare that and much more from the enormous hoard now held by the Bank of England for itself and that held at the Bank of England for the Government notes [i.e., the £28½ million then held for the Currency Note Account.]

That reminds me that your table on the last page is a little misleading about the paper and gold in this country. To the gold held by the Bank of England you should add the £28,500,000 held against the Government £1 and 10*s*. Currency (commonly but unofficially called Treasury) Notes: from the Bank of England Notes should be deducted £19,450,000 of them which are locked up in the Currency Note Reserve: and there should then be added the £368,000,000 of Currency Notes outstanding at the end of 1920 (now reduced to £300,000,000). (There are also the Scotch and Irish bank-notes so far as not covered by Currency Notes, but we do not worry about that as it is a small fixed sum, the banks being under the same law as the Bank of England in having to find cover for all notes issued above this sum.) This raises the gold to 3,920 million fr. and the paper to 12,521, and lowers the ratio to 31 per cent.

Your figures for Spain and Switzerland are rather amusing in view of the common impression that a stock of gold in the cellar which is on no account to be paid out "supports" or "backs" a

paper issue. If I were the Government and could do what I liked without considering people's ignorant prejudices, I would take the Bank of England Notes out of the Currency Note Reserve, send them in to the Bank for gold, export the £19,500,000 to America and buy in Currency Notes. I should be able to get about £20,000,000 of them, and the rest would stand at par, and we should be at the end of our fall of prices, and be able to restore convertibility and a stable exchange with gold standard countries at once. I believe a short and sharp adjustment much better than a long-drawn-out agony.

III

TAXABLE CAPACITY: AND THE BURDEN OF DEBT

[From a review of Sir Josiah Stamp's *Wealth and Taxable Capacity*, 1922, in the *Statistical Journal* for May, 1922.]

. . . In the chapter on the limits of taxable capacity the author is perhaps a little too merciful to those who think that by easy exercises in simple arithmetic they can tell us within a pound or two the aggregate sum which the Government of this country can take from us in taxation without "exceeding our taxable capacity," and assume that we cannot reduce our consumption below what we are used to. But he is convincing in his insistence on the importance of the destination of the proceeds of the taxation, the sentiment of the taxpayer towards the authority imposing the taxation, the methods of taxing, the distribution and magnitude of wealth. He seems to leave a little obscurity round the question whether taxable capacity is to be taken as capacity to bear taxes without suffering (and so is all a matter of degree if we assume that no tax is borne with pleasure) or capacity to pay regardless of suffering. In the earlier controversy about the taxable capacity of Ireland to which he refers, what agitated people's minds was the fairness of the distribution of a total burden between Great Britain and Ireland, and this in no way raised the question how much could at a pinch be got (continuously) from either or both of the two countries. In the more recent controversy the allegation that taxation exceeds our taxable capacity seems to be intended to mean that the existing

taxation is so high that the present yield cannot be expected to continue, owing to the exaction drying up the sources from which it is obtained. The pleasure which a considerable section of the public seems to take in discussing those doctrines of aggregates is perhaps a little unfortunate, because it distracts attention from the real practical difficulty, which is to fix upon the expenses which are not worth the taxes they necessitate, and cut them off. We are all agreed that there are such expenses, but one of us says, "Cut down schoolmasters' salaries, but leave us our defences!", and another, "Give up the weather-chart with which the Air Ministry competes with the pavement-artist in Kingsway, but don't touch Education!"

. . . In the sixth chapter Sir Josiah examines the burden of our national debt and the suggestions for relieving it—without enthusiasm. He remarks that if we do as well as our ancestors did in the period after 1817, we may reduce it in 37 years by perhaps 450 millions! Conversion, he says, did little for them, and will not do much for us. To those who want to keep prices up in order to make the burden of national debt less heavy, he points out that much of the war debt was contracted before prices had risen to the level at which they stood when he was speaking, and the earliest investors in war-savings certificates who withdrew their pounds at the end of the five years actually got less than the 15*s.* 6*d.* which they put in. It would be very interesting if he would bring his unrivalled qualifications to bear on the more general question of the good and bad results of restoring old standards when not only the national debt but all kinds of debts and fixed money charges are taken into the account. The glib statement often made that "it does not matter where you stabilize the Austrian crown provided you stabilize it somewhere," is quite untrue: nor is it true that "you do as much injustice by restoring a fallen standard as you did by depreciating it." When an old standard is restored after not many years, *some* at least of the injustices and inconveniences of its depreciation are repaired. How much there is of this reparation to set against the new injustice seems to depend on the extent to which property and obligations have been bought and sold, and on this an infinite amount of statistical work might conceivably be expended with advantage. It might help to settle the question what compromise should be made between the old and the existing level

of prices, and possibly it might suggest some modern substitute for the sliding-scale system adopted in France in 1797, and in Denmark during 1813–38. In this and similarly placed countries the question is not practically important, since in the end the person who owns a pre-war fixed charge will find it depreciated probably by less than 50 per cent., and even that depreciation will be obscured by the charge being worth as much gold as before: but in Austria it is quite an open question whether the owner of a pre-war fixed charge will eventually be receiving the old quantity of gold or one two-thousandth of it.

IV

COST, RENT, "WAITING" AND SUPPLY AND DEMAND

[A review in the *Economic Journal* for June, 1922, of Hubert D. Henderson's *Supply and Demand*, 1922, one of the Cambridge Economic Handbooks.

"Professor Irving Fisher's German alchemist" was a contemporary person, referred to by Professor Fisher as claiming that he had discovered how to make gold out of cheaper material.

Not long after this a member of an Australian legislature who rashly mentioned "the law of supply and demand," was met with a cry of "Which one? I have a book here which says there are seven!"]

"Generally speaking," Mr. Keynes tells us in his preface to the whole series, "the writers of these volumes believe themselves to be orthodox members of the Cambridge School of Economics." Outsiders sometimes are inclined to look on that school as somewhat of a "sect" in the sense in which that term was applied to the Physiocrats. It is refreshing, therefore, to find that Mr. Henderson courageously throws overboard the traditional doctrine of real cost in efforts and sacrifices in favour of the modern doctrine which Davenport calls "opportunity-cost" and Ricci "equilibrium," and which has as yet received no very satisfactory name. Orthodoxy no longer insists on our accepting the curse of Adam as the basis of economics. We can happily abandon the belief that to hammer in a nail or to paint a Madonna is always a grievous effort, and that it is always a painful sacrifice for a millionaire not to keep a steam-yacht. "The real cost of anything," Mr. Henderson says, "is the curtailment of the supply of

other useful things which the production of that particular thing entails." When the "real cost" of a pound of sugar is thus reduced to the honey or pepper which you might have had instead, just as the real cost of an afternoon's golf might be the afternoon in a boat which you did not take, it becomes such a shadow of its former self as to be quite innocuous.

The full implication of the new doctrine has not been quite grasped. Rejection of the traditional doctrine of real or absolute cost should carry with it rejection of the traditional theory of rent. That theory endured so long as it was held that ordinary commodities owed their value to the grievous efforts and sacrifices which attended their production. Land then appeared exceptional. When we cease to believe that the value of ordinary commodities is based on blood and tears, we have no need for a special explanation of the value of land. Here, however, Mr. Henderson tries to be conservative, and holds that land is exceptional because its quality varies from piece to piece and its total supply is fixed. But surely in ordinary things variation of quality is more common than uniformity. The chairs, factories, ships, and locomotives existing at any moment are of innumerable degrees of quality. Even those which were originally alike have become different owing to diverse usage and lapse of time, and it is easy to exaggerate the extent to which things are originally alike. It is said that shipbuilders cannot turn out two ships exactly equal in speed, and all of us who have tried cheap watches know that watchmakers cannot make two of them keep the same time, to say nothing of keeping the time laid down at Greenwich Observatory. And as for the supposed fixity of supply, this does not exist for land in any other sense than that in which it exists for all terrestrial matter. Labour cannot add, it is true, to the area of the globe, but neither can it add to the quantity of gold (*pace* Professor Irving Fisher's German alchemist!). What labour *can* do is to make the existing materials accessible, and to shape them or join them together into useful instruments, and this is exactly what labour does with land, with exactly the same effect upon its value that it has on the value of "materials." The farm of civilized man is "constructed" just as truly as his house is constructed by human labour: its situation in relation to markets for its produce can be altered by human labour—the Panama Canal has almost justified the open-mindedness of the

man at the wheel who asked the officer of the watch on a ship on which I was travelling whether we had to pass Cape Horn on the port or the starboard side. To say that land cannot be increased except by increase of the number of acres is like saying that the locomotive power possessed by a railway cannot be increased except by increasing the number of its engines. As a productive instrument land can be increased or diminished just like other machinery, by improvement or deterioration of its quality.

In the chapter on Capital, Mr. Henderson appears mystical. "We cannot rest content with saying that it consists of factories and machinery, and that these are essential to the worker . . . we have now to get behind the real goods to something else." This mysterious something seems to be "waiting," which is the "essential reality underlying the phenomena of capital and interest," and "constitutes an independent factor of production, distinct from labour and nature and equally necessary." When I was quite a little boy I expended two or three weeks' money-income in the purchase of a pair of pincers with which during a space of forty-five years I extracted innumerable nails and tacks and one wart. I am prepared to say that I saved the money with which I bought the pincers, and that the community added the pincers to its capital. I have no great objection to saying that I abstained from the immediate consumption of oranges and ginger-beer in order to invest in the pincers, but I do object most strongly to being asked to "get behind" the pincers to "waiting," and to being told, "It is this waiting which is the essential reality underlying the phenomena of capital and interest. It is really this which constitutes an independent factor of production, distinct from labour and nature, and equally necessary." To say that the community "waited" when it chose to employ itself in making a pair of pincers instead of employing itself in making several pints of ginger-beer may be only another, though worse, way of saying that it "abstained from immediate consumption," which does not, like "waited," imply that it did nothing. But to say that the abstention is an independent factor of production is highly mystical. It was with the pincers that I extracted the tacks and the wart, not with the abstention, and the pincers would have served me just as well if they had dropped at my feet from a neighbouring star. I am not at all clear what Mr. Henderson believes to have happened when I at last inadvertently buried the

pincers alive in some unknown spot in the garden. My own impression is that I then lost an old and valued instrument of production, *waited* (in the ordinary sense) some time in hopes of finding it again, and during that unproductive period perforce abstained from various actions which would have added to my comfort. But Mr. Henderson, I think, would have me believe that I waited for the forty-five years during which I had the use of the pincers, and then my waiting came to an end.

The book might be improved here and there by a little meticulous criticism of the use of words. Why copy Jevons' (*Theory*, 2nd edition, p. 91) wild statement that " market " meant " originally " a " place " where things are sold ? A market was " originally " a market, and not the place where, weekly or otherwise, the market was held. Haymarket and Clare Market are no doubt places, but they took their names from the markets held there. More important terms are the very elusive ones which serve for a title of the book. What do " supply " and " demand " mean ? It is well to avoid the too common practice of laying down fanciful definitions of terms at the beginning of a book and then straightway forgetting all about them and using the terms in their ordinary and usually numerous senses, but Mr. Henderson ought not to expect his readers to know without any explanation what he means by things " produced in quantities many times in excess of the demand for them," and others falling " far short of what was required " in a world in which there was no economic order (pp. 8 and 9). Later on, it is true, he does try to unravel the ambiguity of " increase of demand," but rather weakly takes refuge in " diagramese " instead of trying Sidgwick's luminous English, which is much plainer.

I wonder whether the persons who talk glibly of the law of supply and demand will be surprised to hear that there are seven laws worthy of thick type. I am inclined to boggle over the fourth of these. Can Mr. Henderson really be " reasonably sure that over a short period an increase of demand will raise the price " of an article which can be produced cheaper in large quantities than in small ? If the demand for his book increases, will the price of it be raised before it is lowered ? It is true that where the increase of demand is both violent and unexpected, a temporary rise of price may occur, but the normal progress of things is for increase of demand to cause the article which can

be produced cheaper in large quantities to fall in price without any preliminary rise. Cost to the producer gradually diminishing as the sale gradually increases, the price falls without jumping up first.

Taken as a whole, Mr. Henderson's work deserves high praise. He has the true academic spirit which forces those who possess it to speak the truth without laying undue emphasis on things which seem to tell in favour of their own views of what ought to be. The last generation of economic teachers, revolting against the eighteenth-century glorification of the rule of a very chimerical Nature, were far too prone to insist on the defects and diseases of the existing economic organization, and to forget that their pupils had not, like themselves, been grounded on expositions of the perfection with which it worked. Their disciples then proceeded, sometimes to the horror of their masters, to propose medicines and surgical operations for the unfortunate economic body which no one with a knowledge of its constitution and anatomy could possibly approve. Now that academic instruction in economics has become a serious thing, a new class of teacher is being evolved and the elements of the subject are being taught in the same way as those of other sciences. The volume before us is a useful contribution to the work, and if the rest of the books in Mr. Keynes' series keep up to the standard set by it, the " Cambridge School " will be entitled to much gratitude.

V

BOOMS

[A review in the *Economic Journal* for September, 1922, of F. Lavington, *The Trade Cycle: An Account of the Causes producing Rhythmical Changes in the Activity of Business*, 1922.]

It is tolerably obvious that if there existed more foresight among mankind, the alternation of ordinary booms and depressions would be deprived of some of its violence. If more people recognized that a boom was a temporary phenomenon, there would be less readiness to buy and more readiness to sell, and consequently prices would be lower ; if more people recognized that a depression was temporary there would be more readiness to buy and less

readiness to sell, and consequently prices would be higher. Chancellors of the Exchequer have some inkling of this when they try Couéism in a depression, declaring fervently that things are looking up; on rarer occasions they apply the equally wholesome converse of Couéism by warning the public that things are not as good as they seem. They do well, and so do level-headed business men who make money by quietly selling at the top and buying at the bottom. So also does the humdrum or normal lecturer on economics who explains to his students that a great part, sometimes probably almost the whole of the rise of prices in a boom and of the fall of prices in a depression is the result of miscalculation in the sense of over-estimation of the prices which can be advantageously paid during the boom and under-estimation of those which can be paid during the depression. Students who have attended to his teaching will be more likely to join the ranks of the more level-headed business men and politicians, and thus to help to moderate the fluctuations of the future.

One who has grasped the great importance of this aspect of the question is likely to turn with distaste from the search for ultimate causes of the fluctuation. The fisherman can pull his boat up on the shore just out of reach of the tide without any knowledge of the cause which set the moon revolving round the earth or the earth turning on its axis. What matters if it was a sunspot or some other trifling celestial or terrestrial disturbance that started the trade fluctuation? The effect would only be trifling if it were not for miscalculation; let us get rid of miscalculation and never mind about the original causes, which we probably cannot alter even if we knew them!

This was probably Mr. Lavington's attitude before the war, and it was then a very good attitude. It would be still a reasonable attitude if he was writing for all time with no particular reference to the facts of the present moment. But to adopt it as he does, specially in reference to the present situation of the commercial world, seems singularly inappropriate. It is much as if, on finding a number of persons in the various stages which follow the consumption of an excessive quantity of intoxicating liquor, we were to explain blandly that the effects would not be nearly so serious if they would only resist the feelings first of hilarity and subsequently of depression which they experience. Just now it happens that instead of a world-wide boom or depression difficult

to account for with certainty just because we cannot test theory by comparison of many examples, we have some countries displaying the usual characteristics of boom and others displaying those of depression. The original cause is made obvious, and it is so enormously powerful that there is no need in dealing with it to insist on the manner in which the effects of obscure and trifling original causes are in the habit of giving rise to miscalculations so that molehills become mountains. It was not the "over-confidence" of business men which caused the immense rise of prices during the war but the fact that belligerent Governments all undertook to buy amounts of goods and services prodigiously in excess of what they usually bought. If they had first or simultaneously diminished (by taxation or borrowing) the amount of money which their subjects could lay out in purchases, this would have made no difference to prices; as they did very little in that direction, prices rose, as in any other case of additional buying. If Governments had been like private persons or institutions who have undertaken to buy more than they can pay for, they would then have gone bankrupt, and the boom would have collapsed with the sale of the bankrupts' stock. Being unlike private persons, they were able to disguise their real failure to pay what they had promised by dealing out additional legal tender units of account which they printed or allowed their banks to print for the purpose. The discovery or re-discovery and utilization of this fresh and apparently limitless source of purchasing power relieved the Governments and the institutions immediately dependent on them of all fear of shortage of cash: an all-round orgy of spending took place, and promises to pay "pounds" or "marks" were legally met by paying in pounds and marks which were always worth less when they were paid than when they were promised.

In spite of popular ignorance and a good deal of gross and inexcusable blindness on the part of the "better-instructed,"[1] some Governments have seen that this new-found El Dorado could not endure for ever. So long indeed as the legal tender possesses any purchasing power at all, the talk of its not being "worth the paper it is printed on" is rather foolish: a million

[1] This was the term which Mr. Asquith had once rashly applied to those who disbelieved that the rise of prices was due to the emission of paper money.

one-rouble notes would certainly not be worth printing, but the ten-million note costs no more to print than a one-rouble note and is worth nearly as much as a Bradbury; if that is not enough, it is easy to print "M" for milliard. But sooner or later there comes an end, and appreciation of the fact has caused the stoppage of further issues in some countries: in others the increase still goes on. Those in which it was stopped were promptly smitten with the dislocation which comes from a cessation of a continuous rise of prices, and those in which it has continued are simply going on as before, enjoying, though scarcely rejoicing in, the boom.

Yet Mr. Lavington begins his book with an introductory chapter which is directed towards convincing his readers that "the main causes of our present condition are to be found not in the outstanding events of the past seven years, but in the more normal operation of the influences which produce business cycles," and that too although our condition of depression is "without parallel in business memories."

This doctrine is made all the more surprising by the fact that Mr. Lavington admits (p. 67) that an ordinary boom is eventually checked by shortage of legal tender, and that this would not happen if bank reserves "were replenished by the continuous manufacture of new legal tender money." "In actual fact," he says, "of course, the supply of legal tender is usually limited. In pre-war days in this country it was limited by the available quantity of gold; in post-war days it is limited by the restriction upon the fiduciary issue of Treasury notes." True enough, but is the intervening period of six years from August, 1914, till the Cunliffe curb became effective in the summer of 1920 to be ignored? Is it nothing that during that period neither of the restrictions was in force and the amount of legal tender was in fact expanded to two or three times its former size? On pages 10 and 11 Mr. Lavington argues that the war cannot be responsible for the depression, because we were booming till the spring of 1920 and "the transition from a period of extreme activity to one of unexampled depression" at that date cannot be explained by "circumstances due to the war." But if one of the circumstances due to the war was the removal of the ordinary check to booms and this check remained off till the spring of 1920 and then was reimposed, the abrupt transition from the great and long-

continued war-boom to the depression, which every economist worthy of the name had always foreseen and foretold, scarcely needs a search for "more obscure influences."

Divested of its topical part and definitely taken to apply to a state of things in which currency is stable, the book is attractive and sound, and after all, the very term "trade cycle" seems to imply a kind of regularity incompatible with the introduction of the apparently lawless passions which bring about great wars and their disastrous consequences. One or two suggestions may be hazarded. In dealing with the fact that constructional industry is the most liable to fluctuation, Mr. Lavington might consider the relation of this to variations in the total amount of savings or new capital coming forward. Savings being mostly invested in constructions, it seems difficult not to believe that variations in their amount must affect constructional employment, and the question arises, how are savings affected in the progress of a cycle? If they are greater in the whole of a boom than in the whole of a depression, it does not follow that there may not be an important change as the boom or the depression proceeds. For the prevention of the violence of fluctuation it is no doubt right and useful to recommend quicker adjustment of wages upwards as well as downwards, but is it much use to bring out once more the old proposal that local and national authorities should throw their weight into the scales in opposition to the prevailing sentiment—that they should employ fewer persons in time of boom and more in time of depression? Does not the proposal require that these authorities should be more level-headed and foreseeing than private persons and institutions, whereas the observed fact is that they are less so? Representing the majority, they are likely to launch out further in time of boom and draw in further during depression than the whole mass of business men which contains a number who can act and do act in prudent disregard of prevailing sentiment. And finally, is it not rather a mistake to omit the stock comparison of the comparative advantages of the boom and the depression? Without this the reader will be apt to remain in the usual belief of the vulgar that the boom is the thing to pray for rather than the elusive normal, which never exists except at a point of time with neither parts nor magnitude as the depression passes into boom and *vice versa.* Yet though the position of the unemployed is unpleasant, there

is little doubt that in depression the whole mass seems not only more industrious but also more contented and happy than in boom. Whether this is because it is really better off or only because the position of the employed, though absolutely worse, is better in comparison with that of the employers, is one of those interesting subjects of economic speculation to which no very certain answer can be given.

VI

HOW MUCH CAN WE PROFITABLY INDUCE GERMANY TO PAY?

[A contribution to a symposium by six professors on the question " How much can the Allies induce Germany to pay with Advantage to Themselves ? " in the *Manchester Guardian Commercial* Supplement, No. 8, on Reconstruction in Europe, for September 28, 1922.

The other five contributors were Professors Gide of Paris, Einaudi of Turin, Cassel of Stockholm, Bruins of Rotterdam, and Andréades of Athens.]

At the present moment Germany's capacity to pay is small. Like some of her neighbours, she has been demoralized by the perpetual increase of paper currency, which has effected the greatest robbery in history, the robbery of all who hold fixed money obligations, such as the public and private debts, mortgages, debentures, preference shares, insurance policies, and pensions, which play a far larger part in modern civilization than in earlier times. The loot goes chiefly to the owners of other kinds of property, and the State itself is not benefited, though it manufactures the money cheaply enough, as it finds it impossible to raise its money revenue as fast as its money expenses rise under the forcing influence of a depreciating currency. But rapid increase of currency and consequent depreciation is necessarily a passing phase of short duration. If the increase is not checked the paper mark will soon have followed the classic assignats and the quite recent Mexican issues into the waste-paper basket, and the German people will be using some better standard, old or new.

With a properly limited currency Germany will soon find her feet again and be able to pay a good deal, if she is willing. I

have no patience with those who imagine that how much she can pay can be discovered by an examination of her balance of trade, either before the war or now. One of the most certain things in economics is that a country's balance of trade depends on what she chooses or is obliged to pay. It is no use to say that we cannot pay America $250,000,000 a year because our balance of trade is insufficient: the payment will be made by giving more or getting less, or a combination of both. If anyone is determined to discover what a willing Germany *could* pay, he must try some different method. He might take, in the first place, her pre-war tax revenue: double it, on the principle that twice that amount could probably have been raised at a pinch, even if none of the increase had been returned in interest and gratuitous payments to inhabitants of the country: increase the doubled tax-revenue and the old expenditure out of taxes by 50 per cent. for the reduced commodity-purchasing power of gold: deduct the new expenditure figure from the new revenue figure, and apply to the difference an increase or diminution based on a comparison of the percentage of capacity to pay estimated to have been lost in consequence of Germany's diminution of territory, foreign property, and man-power with the percentage of capacity to pay estimated to have been gained by reduction of the estimated necessity for armaments. The calculation bristles with difficulties and uncertainties, but would doubtless bring out an annual sum far greater than the most sanguine of the Allies expects to be actually forthcoming.

Of course, if Germany were willing to pay this great sum, it would be to the advantage of the Allies to receive it. The doctrine usually attributed to Norman Angell that it is economically more advantageous to give than to receive an international payment is ridiculous. If it were true, every intelligent country might make itself rich with ease, as there will always be plenty of disbelieving countries ready to accept a gift: and if there were no such countries, it would still be possible for each country to put goods ashore on uninhabited islands, or, simpler still, throw them overboard somewhere beyond the three-mile territorial limit.

Nor is there any need for fuss about the manner of payment. It is not a good plan for the Allied Governments to specify all the commodities and services which they think their respective

countries want. Far better to state the amount to be paid in gold and accept the equivalent in their own currencies, so that the actual goods transmitted by Germany may be the optical instruments, the tin engines for children, the fabric gloves, and all the other things which Germans find it most convenient to sell and the inhabitants of the Allied countries find it convenient to buy, except when they are prevented by the clamour of fellow-countrymen who want to make these things and be paid more for doing it than the Germans.

The real difficulty is not that Germany cannot pay, nor that it would not be pleasant and easy to receive this great sum, but that Germany is not willing to pay it or any other sum, big or little. So the practical question put at the head of this paper, is how much of the sum she can be "induced" to pay. "Inducement" possibly covers compulsion, but experience, ancient and modern, especially very modern, shows it to be extremely difficult for one nation to keep another even in merely nominal subjection, unless there is a very wide difference in civilization or racial capacity between the two. It is still more difficult for the alien governors to make a profit out of their domination; the Romans, and at a later period the Turks, may perhaps have got a net profit out of Egypt, but such cases are almost, if not quite, unknown in modern times. I am sure that there is no long-run profit but only loss to be got out of the "drastic" measures for compelling Germany to pay which are recommended by the more childish class of politician. What, then, remains? Nothing but that the Allies must induce Germany to pay something by offering in exchange all that they can give without disadvantage to themselves.

That does not include a loan. The cry of the countries with the most depreciated currencies for "credits" suggests the plea of the drunken man for a stiff glass of whisky just to set him on his legs again. More money is not the cure for too much. A loan from abroad would only delay the necessary pinch.

What the Allies can offer Germany without disadvantage to themselves is (1) guarantees of peace, goodwill, and freedom of trade and personal intercourse; and (2) retirement from the occupied territory. For these things Germany would be both able and willing to pay largely.

And to pay quickly. The abolition of discriminations against

Germany and the evacuation of the occupied territory could be arranged to take place *pari passu* with her payments, so that by accelerating payment she could accelerate happier conditions. The idea of annuities to be paid by the German Government to the Allied Governments over a long term of years should be abandoned. A Germany which had vomited her surfeit of paper money, jettisoned her old belief in the efficacy of war, and been confirmed in the expectation of peace and a proper place in the comity of nations would be willing and able in a few years to raise a large capital sum by borrowing at home and abroad.

But how much could she be induced to pay by this method? That would depend on the bargain effected. The Allied bargainers would be in a strong position because they would be able to point to the fact that large and powerful sections of their citizens are opposed to any leniency towards Germany, and would rejoice to hear that negotiations had failed. To guess at a sum here could do no good. I will only say that I am sure it would be much greater than any which could be obtained by any other method.

VII

"A RIGHT DISCOUNT POLICY" INEFFECTIVE AGAINST EXCESSIVE INCONVERTIBLE PAPER

1.

[A review-article in the *Economic Journal* for December, 1922, of Professor Cassel's *Money and Foreign Exchange after* 1914.]

Professor Cassel tramples down in fine style many of the absurd doctrines with which the European public was bamboozled during the war and for some time afterwards. The few who lifted up their voices in the wilderness will enjoy the contempt with which he examines and dismisses the arguments of the official apologists who denied that their currencies had depreciated, or alleged that the cause of their depreciation was not the manufacture of additional currency, but the "balance of trade," which could be put right in the best mercantilist manner by suitable encouragements of export and discouragements of import. The only doubt that suggests itself in this

province is whether his exposition will really clear up the difficulty which many minds seem to find in seeing exactly why and how the issue of additional currency raises prices. To call the addition " artificial " or " false purchasing power " seems likely to confuse the reader. In a self-contained community which used no money but ounces of gold, additions to the currency owing to output from the mines could not reasonably be described as " artificial or false " purchasing power which would " inevitably compete with the genuine " (p. 19). Surely it is both simpler and truer to say merely that the additional money, whether it is metal or paper, competes with the already existing money in the purchase of commodities and services, and therefore raises the prices of commodities and services. On page 20, Professor Cassel speaks in a way which suggests that the issuer of additional currency is able to purchase commodities and services because prices rise and other buyers consequently cannot buy as much as before. It is " part of the object of inflation to force up the prices of commodities." Is not this putting the matter very perversely? The issuer is able to get commodities and services because he has money to give for them: the rise of prices which his purchases cause goes against him, and makes his new money buy less than an equal amount of money would have done before he came on the market. He does not want a rise of prices at all, and to say that " part of the object " of his issue is a rise of prices is extremely likely to mislead.

It will perhaps be said that there cannot be more than a difference about a method of expression in this matter—that every one, or at any rate every Professor of Economics, must really know why and how additions to currency raise prices, however he may fail in explaining it in lectures or books. This seems likely, but I cannot help thinking that a slight haziness about the fundamentals of the question has a good deal to do with the adoption by Professor Cassel of what is the main gospel of his book, the doctrine that prices must be regulated by a proper " discount policy." Prices existed and were sometimes nearly stable for considerable periods, and sometimes fluctuated rather wildly, long before there were any banks to declare bank rates, and obviously changes of price level would take place even in a community where no one ever borrowed or lent. When we were on a gold standard we thought of the value of gold

falling and prices of commodities rising because men in Australia, Alaska or the Transvaal were producing gold in large quantities and giving it in exchange—"selling" it if you like—for goods and services. We never thought of alleging that it was all the fault of the "central banks," and reproaching them with not keeping bank rates high enough to keep prices down. We knew that prices were being raised by the new gold, and we never dreamt of the output of gold being regulated by a "discount policy." Banks, just like private persons, could, we knew, counteract the effect of the output on the market by storing additional quantities in their cellars, provided that they did not nullify the counteraction by issuing additional paper currency. But to acquire gold and keep it out of use is just as expensive to a bank as it is to an individual, and we never expected the banks to do it because of their love for the world at large.[1] And if such a thing had been proposed we should have said that the banks, even if willing, could do very little in that way.

Similarly, if we were troubled by a fall of prices attributed to the output of gold not keeping pace with the requirements of gold for currency and other purposes, we thought of schemes for "economizing" gold, that is, for throwing it out of certain uses by the provision of substitutes or the adoption of methods which would cause it to be less required. So far as I remember, low bank rates were never recommended for this purpose: we generally had them!

Is the situation fundamentally different to-day? So far as gold money is concerned, evidently not. According to Professor Cassel's view, the American banking organization has recently by a wrong "discount policy" kept the value of gold higher than it should have been, and thereby done a great deal of damage to the United States and other countries on a gold standard or trying to get up to it, but he does not seem to suppose that the wrong policy can continue very long, and in talking of the future when stability of currency will be restored throughout the world, he seems to be thinking much as we used to think about the value of gold, deprecating its use in circula-

[1] [A bracketed parenthesis which does not affect the argument occurs here. I have omitted it, as it contains a blunder about United States history for which I am now quite unable to account.]

tion, the acquisition of large stores, called "reserves," of gold and so on, because he fears a rise of the price level.

Applied to an inconvertible paper currency *issued by an uncontrolled bank*, the discount policy gospel has a little more plausibility. We think of such a bank as issuing this currency by way of loans to borrowers, and consequently issuing more when it charges a low rate for the accommodation than when it charges a high rate. We see that it cannot be stopped from lending by want of means or fear of bankruptcy, since the power of its printing-press to print notes of larger denominations is infinite. (If the noughts are too many to print in a line, the figure can be squared, cubed or raised still higher.) The belief that the bank can only issue the notes by way of loans is incorrect: it can build itself new premises, buy lands and securities. But if we suppose these outlets somehow stopped up, as they might perhaps be if we take the high discount policy to include abstention from expenditure which did not promise a return equal to the rate of discount, it certainly looks legitimate to say that the value of the currency, or (which is the same thing) the level of prices, can be regulated by the discount policy of the bank. But clearly this is only because, under the conditions assumed, the discount policy will regulate the issues and withdrawals of currency: the gospel of discount policy is only a somewhat corrupted version of the good old gospel of due limitation of issue successfully preached by Ricardo and Horner in 1809–19.

Even the corrupted version may perhaps be good enough to put and keep the currencies of Sweden, Holland and a few other countries on the required level. The management of the Swedish Riksbank and Dr. Vissering may possibly find salvation by being converted to it, imperfect as it is. But applied to the greater part of Europe it is, on Professor Cassel's own admission, absolutely useless. For the success of the policy, he says, it "must, of course, be assumed that the State, by its demands for credit, does not force a creation of bank currency nor itself create fresh paper money to cover its own expenditure" (p. 106). This is exactly what can *not* be assumed in all the most troublesome cases of diseased currency systems at the present time. In most of the suffering countries the State is always going to the bank of issue and asking for another loan, and at the moment

the bank has nothing to lend. The President of the Bank might well reply to the Finance Minister, "I am afraid we shall have to print another twenty milliards, and prices are rising already, so that according to Cassel's theory, we must charge you a very high rate: what do you say to 20 per cent.?" "All right," answers the Finance Minister quite cheerfully, "it's all the same to me: by that little arrangement we made the other day all your profits are coming back to the Treasury, so you can charge what you like!" Sometimes the State prints the paper itself and either spends it direct without any disguise, as in Russia, or, as in Great Britain, first goes through the form of "lending" it to itself in Ways and Means Advances or on Treasury Bills and other "Government securities." It is tolerably obvious that no policy of the banks can prevent a Government from itself issuing directly as much inconvertible legal tender money as it chooses: nor is it any use to tell a Government which goes through the hollow form of lending an issue to itself that it ought to charge itself a high rate of interest. In all this immense and important sphere, then, Professor Cassel himself is bound to preach that Governments should meet their expenses by other means than creating new currency, and this is simply the old gospel of due limitation of issue.

But, in scriptural phrase, he "kicks against the pricks." He cannot see much virtue in any limitation except in his own, at best insufficient, and at worst wholly futile, limitation by discount. When notes are convertible into free (i.e., meltable and exportable) gold, they are limited in amount by this convertibility—limited to the amount which can be got into circulation and kept there without driving their value below par with gold. "The liability to redeem notes," Professor Cassel admits, "compels the central bank to adopt a right discount policy, and that has its importance for the maintenance of the monetary unit. But it is not a means to that end." I should say that is exactly what it is, and, moreover, that it is a means which does not act, as he supposes, indirectly through the discount rate, but directly through the limitation of issue caused by the bank not being able to keep the notes outstanding if the gold which it is obliged to give for them is greater in value than they are. The right discount policy of the bank is forced upon it by what the Bank of England directors used to call "consideration for

the safety of their establishment," a thing which it would not have to worry about if it had, and expected always to retain, the power of issuing unlimited paper currency legal tender. Nothing can bankrupt a bank or Government which possesses this power and takes care to owe nothing except money of the country: even the dropping of the value of the currency to zero will not make it unable to pay, since all its obligations can then be paid in waste paper.

If by an unfortunate lapse from sound policy a paper currency has been allowed to lose its convertibility into free gold and fallen below its par with gold and it is decided to bring it up again to that or some other level, the old gospel taught that the institution which had control of the issue, whether bank or Government, should be directed to reduce the amount outstanding (or in a mild case merely to keep it down) till the value of the paper rose to the required level. The Cunliffe Committee accepted that doctrine, and recommended a policy of cautious reduction (First Report, p. 12, top). The Treasury accepted the particular limitation proposed by the Committee at the end of 1919, but owing to the usual seasonal decline at the beginning of the calendar year, this had no operation till a few months later, when it broke the "vicious circle" which people used to talk about, or "pricked the bubble," as their ancestors would have said, with effects terrific to those who believed in a ten-year boom. A right "discount policy" was forced on the banking organization when it could no longer depend on the continuance of the stream of Currency Notes hot from the press. The post-war slump, which every one with any knowledge of history had always expected, at last set in. Professor Cassel is not at all pleased. He belittles the repression and reduction of the notes outstanding, and also the reduction of prices caused by the Committee, saying that "after the Committee issued its first report" the amount of notes outstanding still increased, and the *Economist* "price index rose from 227 in November, 1918, to a maximum of 310 in March, 1920." Is it fair to depreciate the recommendation of a committee because that recommendation did not have the desired effect during twelve months before it was adopted by the Government and a few months more before it came into actual operation?

But in this matter Professor Cassel tries to ride at one and the

same time two horses galloping in contrary directions. While suggesting that the Committee's measure was not very effective, he complains strongly of its effectiveness. Before recommending it, he says, the Committee ought to have thought of the frightful slump it would cause. He has no ground for supposing that they did not. It is true that they painted no picture of the horrors of slump and depression in their reports, but does the fact that a physician has prescribed for a patient without descanting to him on the extreme disagreeableness of the prescription, prove that he was not fully aware of that disagreeableness ?

This brings us to the second great article of Professor Cassel's creed, the doctrine that deflation must always be avoided at all costs. When he sees inflation he cries, " Halt ! but mind you do not recoil a single inch ! " On grounds of justice, as justice is actually conceived by civilized man, this is clearly wrong. The depreciation of money may have been so recent and so violent that less injustice on the whole is done by going back part of the way or even the whole way to the old standard than by adhering exactly to what the newspapers insist on calling " the new low record " of the day. Economic expediency generally agrees with received ideas of justice, and certainly does so here. What precise figure it would be best to select for the stabilization of the German mark here and now on this 1st of November, 1922, it is difficult to say, but all reasonable persons would agree that the figure would be appreciably higher than that of to-day's purchasing power.

Professor Cassel's plan is to accept the price level of the moment and regulate the currency so as to maintain it without change, and so avoid slump and depression. Whether it is completely possible to do this he seems to have some little doubt, but he certainly overrates the extent to which it is possible to approximate to it. Where prices have been rising for some considerable time, business is all carried on under the assumption that the rise will continue : when this assumption is shown to be wrong, and it has to be accepted that prices will rise no further, business arrangements will be upset in exactly the same way as they are upset by a change from a condition of expected stable prices to a condition of expected falling prices, and with exactly the same result of causing a slump and depression. Any-one with diagrammatical tastes may illustrate the angle in the

line of prices for himself, and he will see at once what a jolt can be hidden under the blessed word "stabilization." On the whole a change from a rising line or curve to the horizontal is likely to be more violent, and therefore more disturbing, than a change from the horizontal to a falling line or curve. It may perhaps be suggested that the proper plan is to round off the transition in the way in which the top of a road hill is always rounded off. If the mark is one-thousandth of its old value to-day, announce that the issue of paper marks shall be so regulated that it shall be one-eleven-hundredth six months hence, one-twelve-hundredth say a year hence, and then remain stationary. This, however, is probably quite impracticable, and if it were not, it could only have the effect of moderating the slump while it lengthened the depression.

Depression is the penalty of boom, whether the boom has a monetary or some other origin, and it is scarcely in the nature of things that any means of avoiding it can be discovered. To use unnecessarily strong language about it and harp on its "disastrous" and "appalling" nature is scarcely the way to help us to bear it and emerge from it, or to encourage the countries which are still inflating to face it and get it over. Let us talk rather of the brighter side of the picture. Though Professor Cassel suggests that deflation adds immensely to the difficulty of State finance (p. 206), we have seen the position of our own State finance improve enormously since the deflation began, while that of the inflating countries gets worse and worse. Though we have many unemployed, we have the satisfaction of knowing that the employed in this and other deflated countries are better off than the employed where the inflation boom is still in full swing, and that what they produce is sufficient not only for that but at the same time to provide for the unemployed and incapable, better at any rate than they have ever been provided for at any earlier period—so well, in fact, that the goodness of the provision is supposed to obstruct to an appreciable extent their return to work by preventing necessary reductions of money wages in certain directions. And finally, let us remember what figures will never show, but nearly every one feels, that the people of the deflated countries are, in fact, more happy and contented, less inclined to internal struggle and bloodshed, than they were in the wild orgy of 1919–20. With

these things in our mind we shall be better able to advise our less fortunate neighbours to set aside their fears and face the inevitable inconvenience of stopping the rise of prices.

The question of the moment is not whether these inconveniences might have been slightly less than they have been in the United States, Canada, England, or Sweden, but what is to be done in countries where the unit of account is still depreciating at a terrific and increasing rate. In the worst cases Professor Cassel suggests very reasonably the abandonment of "the old currency" (by which he means the post 1914 paper currency). He would lay "entirely new foundations." But would it not be simpler and easier to use the pre-war foundations? What ails, for instance, the old gold mark? It is just as easy to turn the present paper mark into, say, one-thousandth of a gold mark as it would be to make it one-five-hundredth of a gold unit twice the weight of a gold mark.

But whether the pre-war unit or some other is adopted, it seems unlikely that all obligations to pay marks will be dischargeable at the same rate as that at which the paper notes are taken in. It is more probable that the numerous historical precedents will be followed and a temporal scale set up, beginning at par for pre-war contracts and descending with the recorded depreciation. A plan very difficult, no doubt, to apply and of very imperfect efficacy for its purpose, but perhaps not so impossible in practice as Professor Cassel's rather lofty dismissal of "old claims" as now rendered "practically valueless" by the depreciation of currency, and therefore "disposed of" (p. 268). For my part I find it difficult to conceive that in any moderately civilized country not only the National Debt, but also the debts af local authorities, the debentures and preference stocks of all companies, life assurances, annuities and pensions, rents from long leases, and other obligations expressed in fixed sums of money, can be so easily "disposed of," that is to say, permanently cut down to perhaps a thousandth or a ten-thousandth of their proper value merely because a crazy Government printed a great many inconvertible notes, most of them in 1921–2.

2.

[The foregoing article brought me several inquiries, the first in order though not in time being from Mr. Walter W. Stewart, Director of the Analysis and Research Division of the Federal Reserve Board, who asked from what source I had got the phrase attributed to the Bank of England on pp. 327–8 above, "consideration for the safety of their establishment." To this I replied in the following letter. The italics are Ricardo's own.]

June 28, 1923.

DEAR MR. STEWART,—

I have been looking into the question you ask in your letter of the 14th. The phrase you quote has been in my mind for a long time, and I had lost sight of the origin of it. I now think that I probably got it from Ricardo's pamphlet on the *High Price of Bullion*, pages 16 and 33 (in Ricardo's *Works* edited by McCulloch, pages 269 and 276). On the first of these pages Ricardo puts "fearful for the safety of their establishment" inside quotation marks without saying whom he is quoting from and in a way which suggests that it was a usual expression of theirs. On the other page he gives a long quotation from Thornton, who wrote in 1802, in which Thornton says "the directors of the Bank, as appears by the evidence of some of their body given to Parliament, were disposed to resort to a reduction of their paper as a means of diminishing or removing the excess, and of *thus providing for the security of their establishment,*" and another quotation in which Thornton says "the directors . . . diminish the quantity of their paper *through an anxiety for the safety of their establishment.*" A little lower down Ricardo himself talks of "the necessity which the Bank felt itself under to guard the safety of its establishment." I expect the phrase is in the evidence referred to by Thornton, but I cannot at the moment lay my hand on it. I will let you know later on if I find it. But probably this is enough for your purpose.

In their evidence before the Bullion Committee of 1810 the Governor speaks of "a view to the Bank's own preservation" (p. 81 in the folio edition of Minutes of Evidence), and the Deputy-Governor says the Bank "however reluctantly from a regard to its own security" would have found it necessary to withhold discounts. You will remember that at this period the usury laws prevented the bank rate being above 5 per cent., so that

the Bank had to act on borrowers directly instead of simply choking them off by raising the rate.

I am inclined to think that the most feasible way of keeping gold from depreciating further is to encourage the East to use gold currency. If this could be done it would take off the gold output till the Transvaal sources have become much less prolific. India would probably have had a big gold currency by now if there had been no opposition from England. I cannot think that Europe is likely to want much gold either for currency or reserves: people will be quite content with decent paper and the very small reserves which are in fact amply sufficient. But the East could take a lot of gold. It would further depreciate silver, but that would do us no harm.

3.

[Another inquiry was from Professor Charles J. Bullock of Harvard, who asked what ground there was for the statement in the sentence beginning "On the whole a change" on p. 330 top, above. I replied that on reading the sentence in his letter I thought I could not possibly have written it; then after saying that which I had in mind probably was that inflation has usually been more rapid than deflation, my letter continues as below.]

February 4, 1923.

DEAR PROFESSOR BULLOCK,—

. . . I admit this does not give any real assistance to the argument of the paragraph and if I had had your criticism when the article was in proof, I would have cut out the sentence ("On the whole" to "falling line or curve").

For the rest, any disagreement between us comes, I think, from the rather careless way in which I have assumed that "disturbance" (which may be roughly measured by unemployment) is proportionate to the "violence" of the transition (violence being indicated in the chart by the sharpness of the angle). This is evidently wrong, when we reflect that the terrific drop of prices which occurs when people suddenly revert from a very inflated paper standard to an old metallic standard seems to give very little trouble, at any rate as regards employment. The line in a price chart for France in 1797 and for Mexico a few

years ago would show a perpendicular drop from a rapidly rising curve, but I do not suppose that falls like that ever caused or will cause anything like the unemployment caused by the comparatively moderate falls which have taken place recently in our two countries. Why not? Because the situation is better understood and recognized, and people accommodate themselves to it at once instead of resisting: the necessity of revising all contracts made in what is seen to be a different standard is admitted and the legislature (I can't answer for Mexico, as your magazines resolutely refuse to recognize its existence) arranges for this being done in an orderly manner so far as it possibly can. Your States set the example about 1780, though most of you have forgotten it.

. . . . .

The Austrians seem to be trying Cassel's prescription and they have got the "disturbance." Would it have been worse if they had gone back to gold kronen? "One of the consequences," you say, "might be national bankruptcy." Of course the Austrian Government would have been bankrupt in the sense that it could only have paid a small number of gold kronen for each thousand kronen it had promised to pay. But what has it done now? Paid off milliards of debt contracted in kronen when the krone was equal to a gold krone, to half a gold krone, to a quarter gold krone and so on in paper kronen worth one-eleven-thousandth of a gold krone (which itself is worth much less than some time ago). This, of course, is not "bankruptcy"; nor would this country be bankrupt if our Parliament passed a law that in all Acts and Orders relating to the national debt one penny should be substituted for one pound.

I began remonstrating against the printing of additional currency even before I published *Money* in the latter part of 1918, and therefore do not consider that the world has any right to ask me to find it a painless way out of its trouble. As time goes on, however, I am becoming more and more sure that the least painful way is that of the clean cut, i.e., make up your mind what standard you are going to adopt and go to it at once. When, at the end of 1919 we decided to make the pound once more 113 grains of fine gold, we ought to have bought in the necessary 100 millions of notes at once in a few months instead of spreading the process over 3½ years.

1923

I

ADAM SMITH ON TWENTIETH-CENTURY FINANCE

[An article in the June, 1923, number of *Economica*, the appearance of which, following an article by Dr. James Bonar on "Adam Smith, 1723 and 1923" is explained by the fact that June 5 was the two-hundredth anniversary of Smith's birth.]

ADAM SMITH, who produced his great work at the very late age of fifty-three, did not grow old rapidly, but we can imagine that at two hundred he might have been a little stiff and unable to appreciate at their full value some of the later developments of economics. We can picture his somewhat contemptuous tolerance of

"the very ingenious speculations of Mr. Jevons, Mr. Marshall, Mr. Edgeworth and others, who have introduced a sort of algebra or geometry into the science of political economy. The followers of that system are very numerous; and as men are fond of appearing to understand what surpasses the comprehension of ordinary people, the cypher, as it may be called, in which they have concealed, rather than exposed, their doctrine, has perhaps contributed not a little to increase the number of its admirers. While it has been of scarce any service to the statesman and has done little to provide either a plentiful subsistence for the people or a sufficient revenue for the sovereign, it has at least given rise to much thought and speculation among the youth at the universities, more especially at that of Cambridge, which in my time was sunk in a torpor, no less profound, I believe, than that of Oxford."

He might, perhaps, have doubted whether the adoption of this part of education by women tended, like every part of women's education in his day,

"evidently to some useful purpose; either to improve the natural attractions of their person, or to form their mind to reserve, to

modesty, to chastity and to economy; to render them both likely to become the mistresses of a family, and to behave properly when they have become such." [1]

But at the present juncture it is less interesting to compare the pure science of the *Wealth of Nations* with that of the *Economics of Welfare*, than to ask what Adam Smith might have to say about twentieth-century post-war finance.

"They whom we call politicians," he told his Glasgow students, "are not the most remarkable men in the world for probity and punctuality. Ambassadors from different nations are still less so. . . . The reason of this is that nations treat with one another not above twice or thrice in a century, and they may gain more by one piece of fraud than they lose by having a bad character. . . . Wherever dealings are frequent, a man does not expect to gain so much by any one contract as by probity and punctuality on the whole, and a prudent dealer who is sensible of his real interest would rather choose to lose what he has a right to than give any ground for suspicion. . . . When the greater part of people are merchants, they always bring probity and punctuality into fashion, and these therefore are the principal virtues of a commercial nation." [2]

There is a good deal in this. How pleased Smith would have been to hear that the City approved of the payment of our American debt, and that it was improbable that the less commercial nations would ever fulfil similar obligations! He might perhaps have remembered a passage close to the end of the *Wealth of Nations*:

"The last war, which was undertaken altogether on account of the colonies, cost Great Britain upwards of ninety millions. The Spanish war of 1739 was principally undertaken on their account; in which, and in the French war that was the consequence of it, Great Britain spent upwards of forty millions, a great part of which ought justly to be charged to the colonies."

If the Americans, he might have argued, had long been a commercial nation, they would, perhaps, have reckoned up these sums at compound interest and insisted on setting the resultant sum against the present British debt. As they are only beginners, this much could scarce be expected of them.

No accounts of debtor and creditor would have been necessary if his scheme for giving the colonies representation in "the

[1] *Wealth of Nations*, Ed. Cannan, Vol. II, p. 266.
[2] *Lectures*, pp. 254–5.

states-general of the British empire" proportionate to their taxation had been adopted. He does not seem to have thought the scheme very practicable, but only "not perhaps improper" to be suggested "in a speculative work" like the *Wealth of Nations*.[1] More thoroughgoing than any modern advocate of "Imperial Unity," he was prepared to face a removal of the seat of Imperial Government from England to North America as soon as the North American taxation should become equal to the British, which he thought likely to happen by about the present time:

> "Such has hitherto been the rapid progress of that country in wealth, population, and improvement, that in the course of little more than a century, perhaps, the produce of American might exceed that of British taxation. The seat of the empire would then naturally remove itself to that part of the empire which contributed most to the general defence and support of the whole."[2]

Great Britain having lost the doubtful chance of being part of the "extensive empire" of North America, which, he said, "seems very likely to become one of the greatest and most formidable that ever was in the world,"[3] he would doubtless have adhered to his alternative policy that she should "endeavour to accommodate her future views and designs to the real mediocrity of her circumstances."[4]

He would take a gloomy view of the present problem of national debts. Even in 1776 they were "enormous," and he says they "oppress and will, in the long run, probably ruin all the great nations of Europe,"[5] forgetting what he is said to have once remarked, "there is a great deal of ruin in a nation." His description of the way in which debt is incurred is quite up to date. On the outbreak of war, he says, modern governments

> "are both unwilling and unable to increase their revenue in proportion to the increase of their expence. They are unwilling, for fear of offending the people, who by so great and so sudden an increase of taxes, would soon be disgusted with the war; and they are unable, from not well knowing what taxes would be sufficient to produce the revenue wanted. The facility of borrowing delivers them from the embarrassment which this fear and inability would otherwise

[1] *Wealth of Nations*, Ed. Cannan, Vol. II, p. 419.
[2] *Ibid.*, Vol. II, p. 124.
[3] *Ibid.*, Vol. II, p. 122.
[4] *Ibid.*, Vol. II, p. 433.
[5] *Ibid.*, Vol. II, p. 396.

occasion. By means of borrowing they are enabled, with a very moderate increase of taxes, to raise, from year to year, money sufficient for carrying on the war, and by the practice of perpetual funding they are enabled, with the smallest possible increase of taxes, to raise annually the largest possible sum of money." [1]

The return of peace brings little reduction of taxation, since all or most of the addition imposed during the war is now required to pay interest on the additional debt. If a sinking fund is created, it is always wholly inadequate, and almost always diverted to pay for some new expense:—

"During the most profound peace, various events occur which require an extraordinary expence, and government finds it always more convenient to defray this expence by misapplying the sinking fund than by imposing a new tax. Every new tax is immediately felt more or less by the people. It occasions always some murmur, and meets with some opposition. The more taxes may have been multiplied, the higher they may have been raised upon every different subject of taxation; the more loudly the people complain of every new tax, the more difficult it becomes too either to find out new subjects of taxation, or to raise much higher the taxes already imposed upon the old. A momentary suspension of the payment of debt is not immediately felt by the people, and occasions neither murmur nor complaint. To borrow of the sinking fund is always an obvious and easy expedient for getting out of the present difficulty. The more the public debts may have been accumulated, the more necessary it may have become to study to reduce them, the more dangerous, the more ruinous it may be to misapply any part of the sinking fund; the less likely is the public debt to be reduced to any considerable degree, the more likely, the more certainly, is the sinking fund to be misapplied towards defraying all the extraordinary expences which occur in time of peace. When a nation is already overburdened with taxes, nothing but the necessities of a new war, nothing but either the animosity of national vengeance, or the anxiety for national security, can induce the people to submit, with tolerable patience, to a new tax. Hence the usual misapplication of the sinking fund." [2]

The modern apologists who assert that a national debt is a fine thing and ought not to be reduced, because people who own it can borrow on the security of their holdings, would get short shrift from Adam Smith if we are to judge from the manner in which he treats the author who had represented the public funds

[1] *Wealth of Nations*, Vol. II, p. 405.
[2] *Ibid.*, Vol. II, p. 406.

"as the accumulation of a great capital superadded to the other capital of the country, by means of which its trade is extended, its manufactures multiplied, and its lands cultivated and improved much beyond what they could have been by means of that other capital only." If the owner of an annuity in the public funds borrowed capital on the credit of his annuity, that capital "must have existed in the country before and must have been employed as all other capitals are."[1] And to say that when the debt is held inside the country, all is well, because it is the right hand paying the left, and the money does not leave the country, is an "apology founded altogether in the sophistry of the mercantile system" and, besides, ignores all the inconveniencies of raising money by taxation.[2] "It ought to be remembered that when the wisest government has exhausted all the proper subjects of taxation, it must, in cases of urgent necessity, have recourse to improper ones."[3]

When the national debt is large, it is seldom or never "fairly and completely paid. The liberation of the public revenue, if it has ever been brought about at all, has always been brought about by a bankruptcy; sometimes by an avowed one, but always by a real one, though frequently by a pretended payment."[4] The "pretended payment" was a payment in a depreciated money, and the "most usual expedient" known to Smith was a "raising of the denomination of the coin," i.e., legislation making existing coins legal tender for larger amounts of the money of account than before. This he regarded as less mean than the expedient of reducing the fineness of the coin: "A simple augmentation is an injustice of open violence, whereas an adulteration is an injustice of treacherous fraud," and therefore excites much greater "fury and indignation." The more modern method of depreciating the currency by excessive issues of inconvertible legal tender paper-money, Adam Smith does not formally include, though it had already, as he knew, been evolved by the governments of the American colonies, some of which, he says a few pages further on,

> "like that of Massachusett's Bay, advance upon extraordinary emergencies a paper-money of this kind for defraying the public

[1] *Wealth of Nations*, Vol. II, p. 410.
[2] *Ibid.*, Vol. II, p. 412. [3] *Ibid.*, Vol. II, p. 414.
[4] *Ibid.*, Vol. II, p. 415.

expence, and afterwards, when it suits the conveniency of the colony, redeem it at the depreciated value to which it gradually falls. In 1747 that colony paid, in this manner, the greater part of its public debts, with the tenth part of the money for which its bills had been granted."[1]

No matter what expedient is adopted, an open and avowed bankruptcy is better than a pretended payment in a depreciated currency which extends the calamity from the creditors of the public to the creditors of private persons, and is really worse even for the public creditors, as they are generally creditors of private persons as well as of the public.

"A pretended payment of this kind, therefore, instead of alleviating, aggravates in most cases the loss of the creditors of the public; and without any advantage to the public, extends the calamity to a great number of other innocent people. It occasions a general and most pernicious subversion of the fortunes of private people; enriching in most cases the idle and profuse debtor at the expence of the industrious and frugal creditor, and transporting a great part of the national capital from the hands which were likely to increase and improve it, to those which are likely to dissipate and destroy it. When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least hurtful to the creditor. The honour of a state is surely very poorly provided for, when, in order to cover the disgrace of a real bankruptcy, it has recourse to a juggling trick of this kind, so easily seen through, and at the same time so extremely pernicious.

"Almost all states, however, ancient as well as modern, when reduced to this necessity, have, upon some occasions, played this very juggling trick."[2]

The Romans, Smith believed, reduced the As by three stages to one-twenty-fourth part of its original value. What would he have said of the Austrian Government paying off debt in crowns reduced to one-thirteen-thousandth of their old gold value?

[1] *Wealth of Nations*, Vol. II, p. 426.
[2] *Ibid.*, Vol. II, p. 416.

II

PROFESSORS AND PROTECTION

[A review-article on the Interim Report of the Agricultural Tribunal of Investigation (Command Paper, No. 1842), in the *Economic Journal* for June, 1923.]

"COMMISSIONS" and "Committees of Inquiry," even with a judge as chairman,[1] being a little discredited in these latter days, the late Government in its last hours, thinking the same thing might smell more sweet under another name, decided to set up a "Tribunal of Investigation" to inquire into agricultural methods. The present Government adopted the idea, so that the minute of appointment was signed by Mr. Bonar Law on the 26th of December, 1922.

As if to mark still more completely the abandonment of the effete machinery of the past, the Tribunal is composed entirely of Professors, namely, Sir William Ashley, Professor of Commerce at Birmingham, and Professors Adams and Macgregor, Professors respectively of Political Institutions and Political Economy at Oxford, its academic character being completed by the appointment of Mr. C. S. Orwin, Lecturer in Agricultural Economics at Oxford, as Agricultural Assessor.

The reference to the Tribunal smacks of the politician inexpert in economics and trying, as usual, to combine incompatible ideals. It is "to inquire into the methods which have been adopted in other countries during the last fifty years to increase the prosperity of agriculture and to secure the fullest possible use of the land for the production of food and the employment of labour at a living wage, and to advise as to the methods by which those results can be achieved in this country." What is "agriculture," and when does it "prosper"? Is "agriculture" in this context the cultivation of the fields, and if so, are we to consider it "prospers" (1) when more persons are employed in cultivation, whether their *per capita* product is greater or less, or (2) when the aggregate produce is greater, whether the additional produce is got by a more than proportional or a less than proportional

[1] The reference is to the Coal Industry Commission presided over by Mr. Justice Sankey.

addition to the labour employed, or (3) when the produce *per capita* of persons employed directly and indirectly in agricultural production is greater, whether the aggregate produce is greater or less? It was doubtless some obscure feeling that the prosperity of agriculture required definition that led the framer of the reference to add the words, "and to secure the fullest possible use of the land for the production of food and the employment of labour at a living wage." These words suggest that his ideal of a prosperous agriculture was one in which the greatest possible aggregate produce is combined with the securing of a living wage to the persons employed, farmers being probably supposed able to look after themselves, and landlords, whether dukes or others, being taken as negligible. But this only makes the darkness visible. There are few things more certain than that getting the greatest possible aggregate amount of produce out of the land will prevent what in twentieth-century England is called a "living wage" being available for agricultural labour, and indeed for any kind of labour. Every farmer and every person who has grown potatoes or peas in his garden for his own consumption knows by experience that it is "not worth while" to expend more than a certain limited amount of labour on the land, not because no additional produce could be got by additional labour, but because the additional produce would not be sufficient to remunerate the additional labour at the existing rate. To make arrangements for the fullest possible use of the land would be an attempt towards the attainment of the ideal, rightly derided by J. S. Mill, of a "human anthill," in which the people are as numerous as possible, and all enjoy a "living wage" only in the literal sense of the barest necessaries of life in return for the longest possible hours of the hardest possible labour.

The three Professors, who have all taught economics at one time or another, must have been long acquainted with this economic commonplace, and the Agricultural Assessor has quite recently insisted on it, declaring that if the people of Great Britain want more agriculture they can have it by paying for it, with an emphasis on the condition which to many agriculturists has seemed at least untimely.

We may suppose that the Tribunal resolved to put a "liberal interpretation" on the politician's phrases, and to take it that he really meant his ideal to be the securing of the greatest aggre-

gate produce compatible with the payment of a living wage to the persons employed, and that by a living wage he did not mean anything less than such a wage as country labour would be likely to accept having regard to the remuneration obtainable in other employments. The general idea at the back of his mind evidently was that the Tribunal should study foreign experience and find out from it how the efficiency of British agriculture might be improved—and a very good idea too. It may be, and probably is, true that British agriculture is already so efficient that a day's labour of a given length and intensity in it at present yields more or better product than the same amount in most parts of Europe, but no one supposes that it has nothing to learn even from systems which, on the whole, are inferior. Moreover, "other countries" include not only European countries, but those other countries, British and foreign, across the oceans where the power of the agricultural worker to produce is far greater than in Europe.

If any difficulty is felt about the acceptance of this interpretation of the reference, there can, at any rate, be no doubt that it intended the principal work of the Tribunal to be an investigation of agricultural policy in other countries. It was never framed in the anticipation that the Tribunal might forthwith recommend a policy centuries old for stale old reasons which have been familiar to every one for a century or more. Professors, however, read the newspapers, and the newspapers have discovered from the eastern counties strike and other indications that British agriculture is in a "plight," and that the business of the Tribunal is to pull it out. The Tribunal has responded to the call with a nimbleness which might be envied by mere politicians, and brought out an interim report in which the experience of foreign countries appears as little more than padding, while the staple is recommendation of protective measures based in no way whatever upon that experience.

The report begins with "the very serious crisis with which the agricultural industry in this country is faced," and a description of "the gravity of the immediate state of British agriculture" which is intended to be blood-curdling, but, it must be confessed, reads a little tame to anyone familiar with contemporary descriptions of the same thing after the Napoleonic War. In causing "the depression in agriculture," "drought in

1921 and the heavy fall of prices in 1922 have been main factors." But the Tribunal has no proposals for stabilizing the weather by methods successfully practised in other countries, and does not say that any other country has succeeded in stabilizing the profits of agriculture in favourable and unfavourable seasons. Nor does it consider the cause of the recent fall of prices, and whether it is likely to recur; nor how other industries have met the fall in the price of their products. The immediate crisis is brought up merely to excuse the hurried presentation of a report recommending a few of the usual expedients for fighting one of the most enduring and most satisfactory tendencies of human progress—the tendency for an ever-diminishing proportion of human labour to be required for satisfying the human stomach, which, as Adam Smith observed, is of limited capacity.

Agricultural co-operation and education, which the Tribunal proceeds to praise, are, of course, good things which accelerate this tendency to a diminution of the proportion of persons employed in agriculture in the world at large, but if they are more largely adopted in one country than in others, they may have the effect of concentrating more of the world's agriculture in that country, and so of tending to increase agricultural employment in that country. Whether they actually have that effect in any particular case depends on the particular circumstances. That they would have it in this country the Tribunal assumes by putting them immediately after a paragraph (§ 9) of which the burden is a complaint that "in every other country agriculture plays a larger part in national life." It may quite easily be true, but it surely requires some kind of proof. The countries which occur to the ordinary mind as those in which agriculture plays a very large part in national life are China, India and Russia, none of them specially remarkable for agricultural co-operation and education.

But it is only after this that we come to the real business of "Recommendations." The first suggests some extension of the proposals of the Committee on Credit Facilities, and the next asks for a 25 per cent. reduction of railway rates, at the expense of the taxpayer if it cannot be forced on the companies. Professor Macgregor dissents so far as the taxpayer is concerned. The third recommendation is for renovating and immensely enlarging the Agricultural Rates Act grant by making it equal

to half the produce of the existing rates instead of half the amount levied in 1896. The stock objection that this grant gives most relief where least is needed is not noticed, but Professor Macgregor thinks the recommendation at least precipitate.

After subsidies, Protection, at first in somewhat ludicrous disguise. Farmers would like to have more wheat offals if they were cheaper, and it has been suggested that there would be more and cheaper offals if the importation of flour were stopped, because then, it is argued, wheat would be imported instead of flour, and be milled here, giving out its offals to the British farmer instead of leaving them behind to be sold in the country of origin. "It is probable," says the Tribunal, "that such action would not raise the price of flour in this country, for the existing milling capacity of this country is capable of an output equal to our total consumption of flour." Apart altogether from the possibility that the few great mills in this country, when relieved of foreign competition, might combine to fleece the consumer, this is a very remarkable argument, which shows the value of a correct understanding of the doctrine of the value of joint products. At present, say, of every five bags of flour which we use made out of wheat grown outside the country, four have been milled here from imported wheat, while the other has been milled abroad, leaving the offals behind. Why this proportion? Because, having regard to the prices of both flour and offals and the cost of milling in the various countries of origin and here, this is the proportion which just pays. If more wheat and less flour were sent, it is very likely that the relative cost of milling would be inappreciably affected, but the change would quite obviously tend to reduce the price of offals here (as the Tribunal itself expects) and raise it in the countries of origin. How anyone could fail to see that this would tend to reduce the quantity of wheat sent to this country, and consequently to raise the price of all wheat here, is difficult to imagine. And the position of the Tribunal is not improved by its claim to have found an even better way of cheapening offals without raising the price of flour to the consumer. After the words quoted above it goes on: "We recommend, however, that the import be left open, but that importers of wheat flour should be required to send a corresponding proportion of wheat offals." With every three hundredweights of flour, the importer must bring in

(whether in the same ship or otherwise is not stated) one hundredweight of offals! Really, if Tribunals of Professors are going to make jokes of this quality, near akin to the "jokers" of American protective legislation, the sooner we have the old-fashioned Commissions again the better. Anyone who has ever handled grain and flour knows that if he has the choice of carrying a quantity of grain unmilled or the same quantity after conversion into flour and offals, he will elect to carry the grain unmilled, and consequently the proposal of the Tribunal is fully equivalent to the prohibition of import which it professes to avoid.

Having made this approach the Tribunal now gets to Protection naked and unashamed. It proposes a duty of 10*s.* a quarter on malting barley if imported from foreign countries and 6*s.* 8*d.* if from Dominions, and a duty of 20*s.* per cwt. on foreign and 13*s.* 4*d.* on Dominion hops. Modelling itself on the well-known and in every respect utterly discredited principle of the old English corn-laws, it actually recommends that the importation of potatoes should be prohibited except when licensed by the Board of Trade "after consultation with the Minister of Agriculture as to the extent of home supplies," which means, of course, that the ports are to be shut ordinarily but to be opened when the crop at home is unusually short.

Profesor Macgregor dissents from the recommendation about the imports of flour and offals, and from that about malting barley and hops, but accepts the potato proposal.

The protection of the infant industry of beetroot sugar is to continue "sufficiently long to enable the experiment to be thoroughly tested"; and all imported agricultural produce is to be marked with the name of the country of origin so far as practicable.

The only other important recommendation is that six district agricultural wages boards should be set up in England and Wales to fix minimum wages and give permits only. The argument in favour of this is not well knit, and is probably the result of combining the different contributions of several hands. The idea that something of the kind must be offered to buy off opposition to the "forms of assistance" proposed is not definitely put forward, but seems to underlie the suggestion of sections 35 and 36, that farmers will not work Trade Boards well unless they

"can entertain a certain feeling of security with regard to their business prospects."

"Low wages," says the Tribunal, "are too often coincident with bad farming." It would probably say the same of low rents. But if the farmer, like other producers, is driven to more efficient production by greater outgoings, why is he, unlike them, never driven to more efficient production by smaller incomings resulting from lower prices? The Tribunal may fairly be asked to answer this question in its next report, or in the alternative to say definitely that it does not consider itself appointed to improve the productivity of agricultural industry, but to give us as much agriculture as we are prepared to pay for.

III

THE GOLD MARK WILL BE RESTORED

[A letter remonstrating against the pessimism which was prevalent in the City about the probability of a speedy reform of the German currency. The first two paragraphs of the letter are explained by the fact that the Reichsbank had raised its rate of discount to something like 90 per cent. per annum and its rate on loans to 10 per cent., and it had been suggested that 90 per cent. was prohibitory.

The forecast in the last paragraph turned out quite correct. For more than a year before April, 1925, the pound was unable to "look the mark in the face." See below, pp. 353, 359–62.]

September 17, 1923.

DEAR SIR,—

But is 90 per cent. discount really prohibitive? If some one gave you the choice between a milliard of marks now and ten milliards to be paid a twelvemonth hence, would you take the ten milliards? If you had done so a year ago you would have made a very bad bargain. It is well known that the 30 per cent. rate was absurdly below the market rate.

As to the reduction of the rate on advances to 10 per cent., it is obvious that there can be no intention of lending *in marks* at that rate. Something else is meant. I remember that when the Austrian rate was 12 or somewhere in that neighbourhood, I asked an Austrian what it meant, and he said the banks stipu-

lated for repayment in Swiss francs. Doubtless there is a catch somewhere.

I think you are very incautious in pooh-poohing the possibility of a gold-mark currency being established pretty soon. Experience suggests that peoples do somehow manage to defeat the efforts of their governments to keep them without a decent currency. In former times, down to the case of Mexico only a few years ago, they discarded the government paper and took to hard cash. The German government with the Reichsbank has so far succeeded in preventing that by regulating the import and use of gold so that nobody can import or use it: the Rand is fully aware of this if nobody else is. But the game is nearly up, and the government could now obviously do better for itself by abandoning the present currency and issuing a new one guaranteed not to be issued to such an extent as to make the unit of less value than a gold mark. You may say but where is the guarantee? Of course if the people think the new will go the way of the old, it will fail. But will they? The chervonetz experience suggests that they won't. After the awful experience of the present currency, they will hope for the best. At least £100,000,000 currency must be required in Germany, and to provide that *and no more* in the new paper would be much better business for the government than to go on printing the present issue. I don't say it is certain, but I do think it quite possible that "the pound may not be able to look the mark in the face" any more than it can the American or the Mexican gold dollar.

IV

GOOD MONEY DRIVES OUT BAD IN THE LONG RUN: BUT WHY NOT QUICKER?

[A letter in *The Times* of October 5, 1923.]

SIR,—

No thinking person who has seen (as we all have) something of the effects of rapidly rising prices in creating nervous irritation and consequent economic and political unrest can doubt that Germany's disastrous situation at the present mo-

ment is chiefly due to the badness of her currency. What is most immediately required for her salvation and for the preservation of a great part of the economic machinery of Europe and the world is not an abatement or settlement of reparations or even the evacuation of the Ruhr, but the introduction of a trustworthy currency.

To say "Balance your Budget without the aid of further issues of paper money" is good advice in the earlier stages of depreciation. We ourselves acted on it, and in consequence, in spite of some troubles, we are fairly contented and can and do pay our debts, and that although our debtors do not pay us. But in the very late stage at which Germany has arrived it seems quite impossible that the advice can be taken, at any rate in the absence of great assistance from outside, which is not in the least likely to be given.

But Germany is not the first country which has destroyed the value of a paper currency by putting unlimited quantities of it on the market; nor is she the first in that situation to find no outside assistance. Her predecessors found ways out for themselves, and she will have to do the same. Happily for the world, Gresham's very hasty generalization, "Bad money drives out good," is just the reverse of the truth in the long run. On the whole, the world has progressed from bad currencies to less bad currencies—good money drives out bad. What has usually happened when the Government of a country has inflicted a very rapidly depreciating currency on its subjects for some time is that they have disregarded its wishes, regulations, and penalties, and taken to using something else in place of the Government's legal tender money. That legal tender has then lost all value, and the Government, having no further power to buy without paying, has been compelled to keep its expenditure inside what it can raise by taxation and borrowing.

Why has not this already happened in Germany? Not because of peculiar ignorance and stupidity in the people. They cannot be supposed to have less commercial sense than the Americans in 1780, the French in 1797, or the Mexicans a few years ago. They have in fact displayed a good deal of ingenuity in devising *grundzahl* methods of reckoning values in gold. Then why have they not done what other peoples have done before them—insisted on circulating pieces of valuable metal

which may be trusted to remain valuable since the Government cannot multiply them at will like paper notes?

The answer is, simply because the German Government is not only as stupid as the Governments of the past which have issued unlimited paper, but also, unfortunately, more administratively efficient. In addition to the still large amount of gold in the Reichsbank, which is absolutely of no present use there, there must be many million pounds' worth of other hoarded gold in Germany. It does not come out of the hoards and circulate as money because the Government is able to enforce regulations which prevent the owners from securing full value for it. To take gold into Germany at present would be extremely profitable in the absence of regulations, because it would be the cheapest way of buying things there; Americans and the South African mine-owners are allowed by their own Governments to export gold to Germany, but the German Government makes and is able to enforce regulations which ensure that they shall only do so at a loss—so they abstain from doing it.

If the German Government could only be got to see the desirability of removing its heavy foot so as to allow free dealing in and free import and export of gold, the gold could soon be supplemented by notes redeemable in gold and, like other redeemable issues, limited in quantity by their redeemability. If not, the best hope seems to lie in the possibility of such a weakening of the administration as may lead to failure to enforce the regulations. It will probably be objected that Germany cannot afford a currency mostly or largely composed of precious metal. But a tolerable currency is a necessary of life under modern conditions, and no country, however poor, has ever been prevented from having it by its poverty. The people may be trusted to buy themselves a currency sufficient for their business, even if the incompetence of their rulers prevents their having the cheapest possible one.

V

THE PAYMENTS WHICH HAVE TO BE MADE DETERMINE THE BALANCE OF TRADE

[A letter criticizing a book by two Americans which I had refused to review because I was reluctant to do anything which might be taken as support for extravagant demands for reparations.]

September 30, 1923.

MY DEAR SIR,—

. . . The doctrine that " excess of exports over imports is the only true measure of what a nation can pay " (sufficiently condemned as it is by being " recognized " by such eminently bad authorities as Lloyd George and Briand) is like a red rag to a bull to me. " It is a true measure of what a nation *does* pay " (in tribute, net investment abroad, etc.) would be a defensible statement, but to suggest that the excess in the absence of some payment shows whether the payment *can* be made is simply idiotic. The excess or deficit depends on the payments that have to be made. To say the payment of reparations is to be secured by " requiring the delivery of whatever excess of exports may be developed " is one of the silliest statements yet made. Does anyone seriously imagine that our beginning to pay the interest on our American debt doesn't alter our trade balance by just the amount we have got to pay ? Before, we collected the 30 millions in taxation, and had it to spend again : now, we collect the 30 millions and give it to the Americans to spend. Our consumption of goods is reduced by 30 millions, and that of the outside world is increased by the same amount : this may mean either that we send more of our produce abroad or that we get less of the outside world's produce, or a combination of the two movements. Of course the amount of exports and imports into Germany will be affected in the same way by the amount of reparations exacted.

The Americans' argument about the deliveries in kind is an amazing piece of muddle-headedness. Of course if she's *paying* she isn't getting something in return : the object of reparations is to make her hand over something without getting anything in exchange. " Deliveries in kind reduce capacity to export other articles " : no doubt ; but they might as well say to a man

who owes a hundred pounds, "Don't pay £50, for it will reduce your capacity to pay." The delivery in kind would be part payment and part of the export surplus created by the payment.

In short, if the German Government can raise the required amount by taxation, there won't be the least difficulty about sending it abroad. Exports are always popular, and the populace won't worry about the country getting nothing for them.

VI

ARE CURRENCY NOTES ARBITRARILY LIMITED OR AUTOMATICALLY REGULATED?

1.

[A letter published in the *Economist* of November 3, 1923.]

Sir,—

Two questions occur to me. (1) What is the meaning of "arbitrary" when applied as a term of abuse to the Cunliffe limit on our currency of paper pounds? If an institution—the Treasury in our case under the Act of 1914—is given power to issue bits of paper which must be accepted as "pounds" by everyone to whom "pounds" are due, I fail to see what kind of limit on this power can escape being as "arbitrary" as the power itself. I cannot help suspecting that those who complain of the "arbitrary limit" really wish to see the Treasury exercising its perfectly arbitrary discretion under the Act by increasing the issue whenever sufficiently clamorous interests desire higher prices. If not, will they explain what limit they would suggest?

(2) Is it much use to ask us to decide whether we wish the pound to purchase a stable amount of gold or a stable amount of commodities in general "*under present circumstances*"? Present circumstances will not last, and the essence of business is to see and provide for future circumstances. If this country went back to a gold standard, many others would follow, and stability of exchanges between the whole group would be attained, which would be much more valuable than stability between this country and the United States alone. And even if this

country does not return to a gold standard, is it not now fairly certain that whether their first experiments succeed or fail, Germany and European countries to the east of her will soon be reckoning all prices in gold units, and have a stable exchange among themselves and with the United States? Under *those* circumstances could London afford to go on asking the world to reckon not in gold but in Bradburies, the value of which was kept stable by the Treasury, assisted by the Bank, the Federation of British Industries, and the party agents' calculations of votes at the next general election?

2.

[Another letter to the *Economist*, published December 1, 1923.]

Sir,—

In your last issue Mr. Shaw revives the old doctrine that the issue of Currency Notes is unlike similar issues because it is " automatic."

Will he or some one else explain how the action of the bank of issue officially called the Currency Note Account essentially differs from that of the Reichsbank? When the German Government has been unable to meet its expenses otherwise (i.e., by taxing, by borrowing from private persons or institutions, etc.), the Reichsbank has provided the necessary money by discounting German Treasury Bills, and has got the means to do so by the simple process of printing additional mark notes: when the British Government from 1914 to 1920 was unable to meet its expenses otherwise, the Currency Note Account provided the necessary money by discounting British Treasury Bills and (in the guise of a " Government Department ") making Ways and Means Advances, and got the means to do so by the simple process of printing additional pound notes. Where is the difference?

All that we can claim is that we did not print on the same " kolossal " scale, and that in 1921 and 1922 our Government *more* than met its expenses in the other ways, so that some of the notes outstanding were redeemed, with the natural result of a rise in the value of the pound. Early this year when the policy was on the point of restoring the gold standard here and

leading to a speedy restoration of the uniform basis of reckoning values which had prevailed throughout almost the whole civilized world before the war, faint hearts abandoned it. Since then we have only just "balanced our budget," and consequently have kept the amount outstanding stationary. Now, we seem in some danger of listening to those who wish to see us follow the inspiring example set by the Germans.

I gather from the newspapers that the late President of the Reichsbank to the day of his death refused to believe that the depreciation of the mark was due to excessive issue. If so, I have no doubt that he thought the issue was "automatic" and merely a proper response to the legitimate demands of trade.

VII

EXCHANGE STABILITY OR PRICE STABILITY? KEYNES' CHOICE

[A review in the *Manchester Guardian Commercial* for December 20, 1923, of Mr. Keynes' *Tract on Monetary Reform*, 1923.]

Mr. Keynes' book, held back for a little in order that we might consider it in the calm succeeding the general election, has been expected with some apprehension by those who want to see the restoration of the gold standard and had noticed that some of his more ardent disciples had been clamouring in the Press for a "little" inflation. Alarm was unnecessary: it is not Mr. Keynes who will give us trillions of pounds and the abounding prosperity of Germany.

There are certainly a couple of passages of inflationary tendency. One, on page 69, gives somewhat tepid support to the little inflationists by conjecturing that if prices are stabilized at from 80 to 100 per cent. above the pre-war level we might, perhaps, carry on without either oppressive taxation on earned income or a capital levy, and remarking in a mere parenthesis that such a level of prices is "probably desirable on other grounds." The other passage, on pages 183–4, declares that in the matter of the limit of the fiduciary issue the recommendations of the Cunliffe Committee call for urgent change, since if the limit were

enforced it would "damp down" a "revival" of trade. To damp down booms is just what is required in order to maintain steadiness and the absence of depressions, and the fact is not altered by the boom being called a "revival." And after all, booms did manage to take place on a moderate scale in pre-war days without any addition to the fiduciary note issue and with very little addition to the total currency of notes and gold coin.

But these are aberrations from the main argument of the book, which is that we must keep prices steady by proper management of the paper pound, and give up all aspiration after a return to the gold standard, either at the old par of 113 grains of fine gold or any other, because that standard will not give us stability of prices, and any convenience it might give in foreign exchange would be insufficient compensation for the loss of stability: besides, it is suggested the United States must also abandon gold and pursue internal stability, while Canada and all Latin-American countries would do well to attach themselves by exchange standards to the American dollar, and most of the countries of the eastern hemisphere would do well to attach themselves similarly to the paper pound, so that before long stability of foreign exchange would be added to stability of internal prices. We should have complete stability with the countries in the paper-pound group and approximate stability with those in the dollar group, so long as the policies were successful.

In combating the thick-and-thin believers in gold who think the gold standard the most perfect standard which can, or ever will, be devised by civilized man, Mr. Keynes is on firm ground. As he says, the very moderate amount of stability of value which gold has displayed in the past has been largely due to a fortunate collocation of circumstances, on the continuance of which it would be quite unsafe to rely. The fact that some students, such as Professor Cassel, believe it will get much dearer, and others, such as Professor Irving Fisher, believe it will get much cheaper, scarcely justifies those who do not think they know in striking an average and believing it will remain stable. Mr. Keynes inclines to conjecture that the danger is less of its becoming dearer and depressing prices than of its getting cheaper and bringing about another period of rapid rise

of prices. Its value is only maintained at its present level by the Federal Reserve Board's "costly policy of burying in the vaults of Washington what the miners of the Rand have laboriously brought to the surface" (p. 167) and that policy cannot be continued indefinitely. The United States must sooner or later stop it, whether by letting the purchasing power of the dollar down till it is not worth while for the producers to exchange gold for dollars or by closing the mint to free coinage: in either case the value of gold will collapse.

But against the more moderate opinion which favours an early return to the gold standard without prejudice to the substitution of something better in a not very distant future, Mr. Keynes' case is weak. His forecast of the results of his own scheme is singularly unconvincing. We are not to turn our paper pound into a gold pound because the value of gold (or the value of the dollar, which is the same thing at present) is at the mercy of the Federal Reserve Board, which may either let the value of gold down or ask us to contribute to the cost of maintaining it. But Canada and the countries of Latin America are to trust themselves cheerfully to the Board which sits in New York, and which is not good enough for us. India, Australasia, most of the more civilized parts of Africa, and continental Europe are to adopt a standard which has no other authority than that of being approved by the British Treasury and the Bank of England as stable in Great Britain and Northern Ireland. We can only dimly imagine M. Poincaré's feelings when asked to keep the franc at, say, 80 to a pound, the value of which was managed by the British Treasury, advised, perhaps, by Mr. Keynes.

In fact the recent tendency of Europe, especially since Mr. Keynes began to write his book, has been towards reckoning values in gold. The paper pound has lost, and imaginary gold units which are fractions of the dollar have gained, ground. Even in this country, though we have not yet got to the length of reckoning in "gold pounds," we think of the number of dollars to the pound as giving us the value of pounds rather than the value of dollars. Such credit as the paper pound enjoyed till recently was largely due to the fact that it was expected to rise in terms of gold and dollars. The "little inflation" movement has done something to destroy this credit and accelerate the

"flight to the dollar." The European continental countries will not adopt the paper British pound standard, but will prefer the American gold dollar standard, which has *both* gold and the management of the Federal Reserve Board to support it.

And they will be prudent to do so. Mr. Keynes admits that "it is natural, after what we have experienced, that prudent people should desiderate a standard of value which is independent of Finance Ministers and State Banks. . . . It is felt that the general level of economic and financial education amongst statesmen and bankers is hardly such as to render innovations feasible or safe." But, rather oddly, he suggests that the experience on which "reasonable grounds of hesitation" are "based is by no means fair to the capacities of statesmen and bankers. The non-metallic standards of which we have experience have been anything rather than scientific experiment coolly carried out. They have been a last resort, involuntarily adopted as a result of war or inflationary taxation, when the State finances were already broken or the situation out of hand. Naturally in these circumstances, such practices have been the accompaniment and the prelude of disaster. But we cannot argue from this to what can be achieved in normal times." Mr. Keynes seems to be blinding himself to the fact that these non-metallic standards were adopted by the hard-pressed belligerents at the outbreak of the war and were mismanaged by them long before their finances were broken and the situation out of hand, and also, which is perhaps more important, that they were adopted at the same time and mismanaged by nearly all the neutrals and the belligerents who scarcely suffered by the war.

It was no necessity, but sheer ignorance of the most elementary principles, which led to each country quite gratuitously giving itself a standard of its own even more depreciated than gold had been depreciated by the common disuse of it. Even our own Treasury, with access to the advice of the foremost British experts, denied the whole basis of Mr. Keynes' scheme of stabilization when it declared that the issue of notes was automatic and could not be controlled. And even within the last few months Mr. Keynes' own disciples have been repudiating his scheme by crying out that it must not be put in force

against the *next* rise of prices. And Mr. Keynes himself seems to think so.

No. The road both to exchange and price stability is the speedy restoration of the gold standard everywhere, either with the old unit or some new one. That will at once give the civilized world stability of international exchanges and, taking it as a whole, far greater stability of prices than it has recently enjoyed. We need not be terrified by the bogy of gold getting rapidly cheaper and prices consequently "soaring," nor by the other bogy of gold becoming rapidly dearer and prices consequently slumping. After his recent experiences King Gold will be content to come back as a constitutional monarch. Rise of prices can always be countered by making the units of account contain a greater weight of gold, and fall of prices can be countered by making the units lighter. Agreements between all the countries (or between all that mattered) to raise or lower the weight by uniform percentages would be quite possible and likely, and, after the numerous "devaluations" and adoptions of wholly new units which must precede the restoration of gold, this, the Irving Fisher method, would be fairly intelligible to that part of the public which interests itself in such matters. Over the Keynes method it has the enormous advantage of leaving bankers free to carry on their business as bankers for profit, instead of as philanthropists willing to lose money, and be blackguarded as well, in reward for their efforts to serve mankind.

1924

I

DON'T DECRY THE RENTENMARK

[English opinion continued (see above, p. 347) generally very contemptuous of the reform of the German currency which was being carried out. I thought this an unfortunate mistake.]

1.

[A letter to an old pupil in Berlin. The estimate of the future requirement of £7 10*s*. per head of population has not yet at any rate, in 1927, been nearly reached. The discrepancy between the amount per head in Great Britain and in Germany is striking and deserves inquiry.]

January 7, 1924.

MY DEAR ——

I continue to read *The Times* Berlin correspondence with interest. The exercise of power to put people in quad when they disagree with you on monetary theory is doubtless reprehensible and imprudent: if I had my way in that direction there would not be many monetary experts at large in this country! But I rather think the German Government is in the right in holding that discounting Treasury bills in rentenmarks or billion-marks is not inflation. It all depends on whether its doing so does or does not mean additional issue of currency. Now does it? If the bills themselves are taken as money and can be exchanged for goods like notes, of course there is no question about it. But I don't suppose they are; and whether they are receivable in lieu of taxes doesn't matter: heaps of our war loans have been and some still are so receivable, but it makes no difference. So what I want to know is does this issue of Treasury bills cause more currency in rentenmarks or marks to be issued? If not, then it takes away from the lenders just as much spending

power as the government gets, and consequently no increase of money spent and no resulting rise of prices is promoted.

As to the extra issue of Reichsbank notes, we have got to remember that exactly the same thing happened in Austria without bad result, and that whenever a hitherto rapidly depreciating currency is to be stabilized by devaluation at the existing rate of the moment, a prodigious increase of currency *must* occur. "Must" in the sense that if it didn't, the stabilization rate chosen would be too low—prices would greatly fall. It always seemed to me that the proposed amount of rentenmarks was too small by itself for stabilization at a billion to 1. I should never have limited the figure in any way beyond saying that the issue would stop and if necessary be reduced again whenever the rentenmark showed any sign of going below the value of a free gold mark—that is the limit which convertibility would impose, and it is all that is wanted. Then I'd have stopped the Reichsbank increase altogether. If they prefer to limit the rentenmarks absolutely, there is nothing wrong in the Reichsbank notes being increased up to the amount which will just not make the billion-mark and the rentenmark less than a gold mark: that is the amount which will just provide the total currency necessary, which at recent values has been much too small.

And on that the German calculations seem to me to be underestimates. They seem to assume that about the same total will be required as before the war. But this is quite absurd —quite obviously absurd and contrary to the experience of all other countries in the world. It is bound up with the curious notion which the German public are reported to have got, that they are being swindled if a gold mark does not buy as much as before the war. Of course no piece of gold anywhere in the world will buy as much as before except of bicycles and electric light bulbs and a few other things. The present Germany ought to be able to carry a currency worth about 30 or 40 per cent. bigger than the pre-war one, I should think. To argue that because recently Germany has existed on a few shillings per head it can continue to do so is quite wrong: as soon as people are convinced that the currency is going to continue stable they will enlarge their holdings to a reasonable amount—probably to about 150 gold marks per head of population. (We here had

about 5 gold pounds per head before the war and 8 now). I get rather mixed among your trillions, but if I haven't got a nought or two wrong you are miles below that as yet.

I don't see the point of insisting that the rentenmark is a "purely internal currency": if it is practically exchangeable with a billion marks and 18·4 billion marks are worth on the exchange market £1, then 18·4 rentenmarks are worth £1, whether the exchange quotes them or not. And, what isn't quite realized here yet, the "pound can't look the rentenmark in the face," as the par is 20·43.

2.

[A letter to Mr. Walter Leaf, Chairman of the Westminster Bank. "The gold behind the Bank of England note" is referred to as useless because at that time nobody could draw it out for export or melting, so that it did not for the moment play any part in the monetary situation. The three-year-old prophecy was made in an address given at the Sound Currency Association meeting on January 25, reported in the *British Trade Review* for February, 1921.]

January 26, 1924.

DEAR MR. LEAF,

I think that in your speech you were unduly pessimistic about the new German mark, which seems to be indifferently 1 rentenmark, 1 billion marks, or 1 gold mark. Of course it is quite true that there is nothing in the land security alleged to be behind the rentenmark—it is only eyewash, and no more use than the land behind the assignats or (at present) the gold behind the Bank of England note. But that clearly doesn't matter tuppence, provided the whole currency is properly limited. The total is plenty small enough to start with; I make it only about equal to 84 million gold pounds (1,200 million rentenmarks equal 60 million gold pounds and 474 million billion reichsmarks about 24 million gold pounds). This isn't enough, and if they don't print more notes, they will be importing gold very soon unless they continue their arrangements for keeping it out. Austria in similar circumstances printed a lot more notes and yet keeps quite steady with the dollar now.

Of course you may say that the Government cannot carry on without printing more than this limited extra amount and

will do so. But doesn't that rather overlook the fact that the Government has discovered that it couldn't carry on when it did print *ad lib.*?

However, I dare say you were not quite as gloomy as you made yourself out to be, but wanted to discourage excessive demands for reparations, which is very desirable. The eagerness of our protectionists to demand and their reluctance to receive reparations in any form is rather amusing. So is the fact that the Americans don't seem to suffer anything very terrible in consequence of accepting our 35 millions per annum!

Three years ago I prophesied that some of the most depreciated countries would be back on a gold standard before we should, and it is coming true. If we are too frightened to burn another 20 million of Bradburies and get the £ up to 4·87, for God's sake let us say so, and devalue at 4·50 at once and be done with it. It would at any rate have the advantage of encouraging the other countries to take the same course.

II

"BORROWING FROM BANKS": WHEN PERNICIOUS

[A letter in *The Times*, January 29, 1924.]

SIR,—

Mr. McKenna countenances a dangerous delusion when he says that Government "borrowing from banks" is the great cause of inflation. It is not borrowing from banks that does the mischief, but borrowing from banks which have the power to issue inexpensive legal-tender currency *ad libitum*, and which therefore provide the money borrowed by issuing more notes. If the Government borrow nine millions more from Mr. McKenna's bank, he may interest and delight his shareholders by telling them that he has "created the money," but at his board meetings it will be pretty well understood that if the bank lends more in one direction, it will have less left to lend in other directions: the aggregate money-spending of people and Government together will not be increased, and prices will not be raised.

The Midland Bank cannot, and the whole Big Five cannot, put trillions at the command of the Government, because they

have not got them, and cannot get them by printing them. But the Reichsbank could and did get them by printing them. And so, also, can the curious bank of issue which we call the Currency Note Account, which is, even in official documents, a "Government Department" under the control of the Treasury. It *has* "created" 240 millions and lent them to the Government, and there is nothing whatever except the moderation of the Treasury to prevent it lending the Government 240 trillions and sending the pound down to a billionth of its old value, like the reichsmark. I should not be much afraid of this being done if it had to be definitely agreed on beforehand. The alarming thing is that it can be done without any conscious decision to do it, and that, too, by mere slovenliness. The Government has only to begin and keep on spending rather more in the aggregate than it receives from taxes and loans (from other sources than the Currency Note Account) and the notes will go out; prices will rise because of the additional expenditure, it will then be said that more money is wanted for "productive" credits, and the Cunliffe limit will be withdrawn. Some theorists, if not Mr. McKenna, will insist that the issue is "automatic" and perfectly proper—and so on to the end. The late President of the Reichsbank never believed that his issue had anything to do with the rise of prices!

III

OBSERVATIONS ON THE PRESENT CURRENCY SITUATION (FEB. 6, 1924)

[A Labour Government having just come into power and the advocates of "just a little inflation to set things going" being still active, the position seemed critical. Hence the following memorandum sent to several influential persons after being presented (with a slightly altered ending) to the new Parliamentary Secretary to the Treasury.]

THE cause of the stupendous rise of prices in Germany is pretty well understood in England. Every one knows that it was caused by the German Government's inability or unwillingness to meet all expenses by the ordinary methods of taking money from the people, and its consequent resort to the printing-press. It is recognized that the German Government spent in buying

commodities, in paying for services, and providing subsidies, payments to the Allies, pensions, etc., this sum of about 500 trillions of marks, and that this enormous outlay of money very naturally raised prices with great rapidity, benefiting all those whose incomes were chiefly derived from profit at the expense of those whose incomes were fixed and of the wage-earners, who never could get their money wages raised quickly enough to meet the rise of prices. Every one here knows that the German trillions were provided by the printing-press, and that they could not have been provided otherwise, so that "stopping the printing-press" was bound to stop the rise of prices, whatever incidental inconveniences it might cause.

This is common knowledge. It is also known to every one who is at all conversant with monetary affairs that the actual method of issue was that the German Government got the Reichsbank to discount its Treasury bills, and the Reichsbank found the money to do so by printing the trillions of notes. As there were arrangements which transferred the profits of the issue to the Government the intervention of the Reichsbank made no essential difference: the notes might just as well have been printed and spent directly by the Government itself. There was just this difference. A rise of prices generally *precedes* the expenditure which is its real cause, since people anticipate the expenditure, and naturally adjust prices at once: this being so, the rise of prices usually appeared in advance of the issue of notes, and the issue of notes was consequently supposed to be "called for" by the rise of prices. The late President of the Reichsbank believed this to the day of his death, and would not listen to any suggestion that the issue depreciated the mark. But eventually this transparent fallacy was seen through by every one else in Germany, and (as applied to Germany) it never imposed on us here.

What is not understood even by many experts in this country is that the position here is precisely the same as in Germany, except that the issue has not (yet, at any rate, whatever may be the case in the future) been increased so extravagantly.

Here the "Currency Note Account" is a bank of issue set up by the Currency and Bank Notes Act, 1914, and it occupies exactly the same place and proceeds by the same method as the Reichsbank in Germany. It discounts Treasury bills and makes

advances to the Government just as the Reichsbank did, finding the means to do so in the same way, by the printing and issue of notes.

It has not been able to lend the Government the whole amount of the issue, because 49 millions of it have been spent in acquiring the reserve of gold and bank-notes and 7 millions more in taking over from the Bank silver coin which was no longer required in the circulation, but when the fiduciary issue is 230 millions it has lent the Government that sum plus the notes called in but not yet cancelled and less the 7 millions for the silver coin. The loan is never apparent in the national accounts, because the "Government Securities" held by the Currency Note Account are not specified in the Currency Note weekly return or in any other publication, and previous governments have always succeeded in burking any questions put to them by members of parliament on the subject.

There was no more reason for asserting that the increase of the issue down to 1920 was "called for" by the rise of prices than there was for saying the same thing of the increase of German marks. Anticipation of an increase of prices will always cause an actual immediate increase of prices and a consequent appearance of more cash being "wanted." If, for example, the Government were now to announce that it would spend an additional 1,000 millions in the next twelve months, and it was generally believed that this could and would be done without cutting down any individual's power of spending money, prices would rise enormously at once, and then many experts would go about imitating the late President of the Reichsbank by declaring that the higher prices called for more cash, and that the Cunliffe limit must be withdrawn at once or the revival of trade would be damped down. Now throughout the war, expectation of events causing a continuance of the rise of prices was constantly present, and when the war ended there was still an expectation of a post-war boom. Consequently there was always an apparent demand for more cash, and as this was met by a further supply of notes, prices went on rising unchecked and people almost resigned themselves to what they called "the vicious circle."

The movement could have been stopped at any moment by stopping the further increase of notes, and this was at last done

in 1920, and in the fiscal years 1921–2 and 1922–3 a considerable reduction was effected, the notes being bought in and paid for by money raised from other sources. Prices fell, and then remained fairly stable. Early in the present fiscal year, 1923–4, the gradual reduction ceased, and prices have begun to rise once more and discontent appears already.

It is essential to understand that, with the law in its present state, the regulation of the currency, and through it of prices, does not rest, as some experts imagine, with the banks or the Bank of England, but with the Treasury.

Consider first the reduction of notes. Anyone who has anything worth £1 can sell it and burn the currency note which he gets for it. But individuals will not put money in the fire in order to keep down or reduce prices. Nor will banks. The Federal Reserve Board in America has, it is true, practically buried gold in order to prevent a renewed rise of prices, but that Board is a political board in charge of the national interest just as the Treasury is here. The Bank of England, which is a semi-state institution, could not, however willing, either burn or store away many millions of notes without Government assistance: it simply has not got the means. Putting up the bank rate tends to increase the banks' reserves of cash and this will bring in a few million notes to the Bank of England, but the stream will soon dry up. The Treasury, and the Treasury alone, can draw in and keep in any large quantity of notes, and it can do so, as it did in 1921–2 and 1922–3 by the simple process of raising more money from all sources (other, of course, than the Currency Note Account) than it spends.

I do not think anyone doubts this if the surplus arises from an excess of tax-receipts over expenditure. If the floating and permanent debt remains stationary, and the receipts from taxes exceed the expenditure, it is obvious that the surplus can be spent in burning Currency Notes, and there is not much difficulty in seeing that under present arrangements such a surplus will be so spent, because it will lead to Currency Notes being paid into the Government's bank, the Bank of England, which, instead of writing up the Government's balance by their amount, will pay them into the Currency Note Department, where they will be cancelled. If the Government liked, it could, of course, collect the surplus from the taxpayers directly in Currency

Notes and burn them in Whitehall: the process actually followed is essentially the same, though there may be in short periods of time a little discrepancy between the surplus and the notes cancelled.

Some, however, doubt if reduction of notes will be brought about if the surplus of receipts over expenses arises from a surplus of money *borrowed* over money repaid. But no doubt is really permissible. If the taxes just equal the expenditure, and 50 millions more are raised by loan, it is obvious that the Government can use the 50 millions to buy up and burn Currency Notes to that amount, and there is not much difficulty in seeing that under present arrangements this is just what will happen, since notes will come into the Bank of England and will be paid to the Currency Note Department and cancelled.

Others will admit that this is so if the additional debt contracted is of a "permanent" character, by which they mean practically if it is not in the form of Treasury Bills or Ways and Means Advances. They think of money raised by bills or advances as "borrowed from banks" and somehow created for the purpose by the banks, so that when the Government has borrowed 50 millions more in that way, the banks have just as much or more to lend to individuals than before, and somehow or other the existence of the surplus when it is obtained in this way will not bring notes into the Bank of England. It is difficult to deal with this belief because it is so confused and incapable of clear statement. The point on which its advocates seem to lay most stress is that the holders of Treasury Bills can *force* the issue of more notes by not renewing the bills when they fall due. But if bills are in fact renewed, what of that? And in practice they are renewed, and can always be renewed at the market rate. Moreover, if they were not renewed, and notes had to be issued, this would prove that notes go out when there is a surplus of repayment over borrowing in this way, which is exactly the converse of the disputed proposition that when there is a surplus of borrowing in this way over repayments, notes come in.

Look now at the other side: increase of notes and consequent increase of prices. To bring this about, all the Government has to do is to give up trying to make ends meet. Let it abandon all thought of "balancing its budget" (in the sense in which all

other countries are recommended to do so), and instead, draw on its bankers without making any effort to have a balance with them to meet the cheques. The Bank of England will not be incommoded; it will not have to draw the attention of the Government to the state of their account. Its customers will be induced and enabled by rise of prices to demand Currency Notes, and the Bank will get them from the Currency Notes Department, and the Government will thus be kept in credit, just as the German Government was kept by the Reichsbank notes. And so on to the end: cumulative rise of prices, bitter discontent, outcry first against the profiteers and then against the government which does not hang them, fall of the government by revolution or otherwise, reaction and return to stable currency, probably gold.

By whatever it is caused, the present incipient rise of prices ought to be checked by further reduction of the Currency Notes outstanding. If it is the result of more currency having been made available by importation of notes formerly held abroad or by the dispersion of hoards, it obviously ought to be checked. But it ought also to be checked if it is merely the result of an expectation of "better trade." All economists who have studied the question in recent years agree that the most promising way of preventing or moderating cyclical depressions is to damp the unhealthy boom which precedes and causes the depression. To not only fail to damp such a boom but to encourage it by issuing *more* currency, regardless of the fact that pre-war booms managed to take place with no considerable increase of currency, is mere madness, only recommended by those whose desire to see an end of the dislocation caused by the war has overcome their judgment and those whose desire for profits has overcome their patriotism.

Whether we ought to go much further than just far enough to keep prices down to their present level is of course a more difficult question. But that we should do well to go a *little* further if that would restore the old gold standard I think there can be no doubt. It is worth some sacrifice. The whole outside world is returning rapidly to gold standards whether at the old or some devalued rate, and it will not be good for this country to stand outside the pale. A common standard, even if a little unstable, is extremely desirable; international co-operation,

both political and economic, has been immensely hindered by the exchange difficulties of the last few years, which have led to all sorts of trouble and ill-will between nations. Civilization cannot afford to do without a common standard of value, and gold is the only possible common standard at present. When it is superseded, as it doubtless will be in time by something more stable, its successor will be international also.

If, which is not, I think, very probable, it should turn out that the recent fall of the paper pound in dollars and gold is not an exaggerated and largely temporary phenomenon, the gap between the paper pound and the gold pound might be too big to be wiped out without too great inconvenience, and then we should do well to submit to some devaluation such as reducing the sovereign to the weight of 4½ dollars. I would far rather do that than remain in the wilderness for another forty or even four years. The return to a free gold market and a gold pound of some weight or other ought to be accomplished this year.

IV

THE CHEQUE STAMP TENDS TO KEEP UP THE VALUE OF CURRENCY

[A letter to a City Editor. The curious delusion that if cheques were more used and Currency Notes consequently less wanted, the purchasing power of the note would rise was very widespread, not only in this country but also in France. It was sometimes coupled with a belief that it would prevent the Cunliffe limit pressing so tightly.]

February 10, 1924.

Dear Sir,—

I cannot stomach this doctrine that we ought to use small cheques in order to "economize" our currency notes. Economizing currency is like economizing anything else, equivalent to reduction of demand which tends to diminish the value of the thing economized, and to diminish the value or purchasing power of the paper pound is the last thing we wish to do at present.

The twopenny tax on cheques did tend to make me and other people hold more currency than before, and so was one of the reasons why the issue did not raise prices quite as much as

might have been expected from its magnitude. Anything of the opposite character, tending to make us reduce our holdings, clearly will cause us to spend that much more money than we otherwise should do: it is just the same in its effect as an additional issue, the only difference being that it gives *individuals* more money to spend while the additional issue gives the *government* more money to spend. And it is always the spending of money which raises prices.

We must not attempt to get round the Cunliffe limit whenever it pinches. The whole purpose of that and every other limit is to pinch—to prevent people having enough money to raise prices.

V

LIMITATION OF CURRENCY OR LIMITATION OF CREDIT?

[An article in the *Economic Journal* for March, 1924, which was originally begun as a review of Keynes' *Tract on Monetary Reform*, but ended in being, in the opinion of the Editors (and the author), "scarcely a review," and was therefore printed as an article with a comment by Mr. Keynes appended.]

SEVEN or eight years ago, though military events then seemed incomparably more important than economic policy, I began to be apprehensive about the future of the pound sterling. Professor Shield Nicholson was, I think, the only economist who had at that time expressed any alarm; the provisions of D.O.R.A. were not favourable to criticism of the currency—her threat of fine and imprisonment might be treated lightly, but her suggestion that such conduct would assist the enemy was decidedly deterrent. From the dark days of the spring of 1918 I have devoted the best of my energies to inculcating the doctrine that due limitation of the amount of a currency is necessary for the maintenance of its purchasing power. If I could have foreseen only a tenth of the ruin that neglect of that doctrine was about to bring upon the civilized world in the next six years, I would have given up other avocations in order to give more time to the endeavour to convince unbelieving mankind of its truth.

It is consequently somewhat disconcerting to be told by the

best-known English monetary theorist that the doctrine of limitation of currency is obsolete, and has been replaced by the doctrine that due limitation of credit is what is necessary, and if that is present, currency will somehow manage to be of the right magnitude. For this is what Mr. Keynes says on p. 184:

> "Thus the tendency of to-day—rightly, I think—is to watch and to control the creation of credit and to let the creation of currency follow suit, rather than, as formerly, to watch and to control the creation of currency and to let the creation of credit follow suit."

The passage follows a paragraph in which the Cunliffe limit on Currency Notes is treated with somewhat supercilious contempt, as springing "from a doctrine now out of date and out of accordance with most responsible opinion."

The champion is doughty, but comparison of the state of currencies before the war, when they were limited by the necessity of being kept equal to gold, with their state afterwards when that limit has been removed, encourages me to take up the gauntlet which he has thrown down. I hold that while the control of prices by controlling currency and letting credit follow suit is perfectly real and effectual, the control of prices by controlling credit and letting currency follow suit is altogether chimerical.

Some time before the war, in the old and lamented evening *Westminster Gazette*, Professor Pigou threw what seemed, at any rate to me in my ignorance, new light on the determination of the value or purchasing power of money, by pointing out that it is not the mere existence of an increased quantity of currency which diminishes the value or purchasing power of a unit of that currency, but the spending, or, more exactly, the expectation of the spending, of the additional money.

The importance of the proposition in the widest realm of theory is that it brings currency into line with all other commodities: the "quantity theory" instead of being something special to currency, is seen to be merely what is generally true, that if more of a thing is to be sold, *ceteris paribus*, its value will fall. Knowledge of the fact that the harvest is plentiful, that many houses are being built, and that much coal is being raised to the surface tends to cheapen wheat, houses, and coal: knowledge that the Government or the State bank is going to offer

large quantities of additional legal-tender inconvertible notes in exchange for goods and services tends to cheapen that currency, and knowledge that gold is being brought to the surface in large quantities tends to cheapen a currency composed of gold and paper convertible into gold, provided, of course, that the Mint is open to the new gold.

In practical life recognition of the truth of the proposition is of enormous importance, because it explains the fact that private persons and the banks in which private persons pool their immediate resources can and do raise or lower the value of a currency of a given magnitude by trying to increase or diminish their holdings, and can and do by actual alteration in their holdings nullify or partially counterbalance or aggravate the effect which increase or decrease of the total of currency would otherwise have. If, the total being fixed, each holder or most holders try to reduce their holdings by buying things, prices will rise, and if they try to increase their holdings, prices will fall. The attempt will not last very long. But when the total currency is being altered, their action becomes more important, because it constantly tends to make people disbelieve in the working of the quantity theory, and induces them to deny that the issue of more and more currency is having its effect. They see no exact correspondence between the issue and the depreciation, and find that the depreciation generally precedes the issue in point of time. Then, forgetting that the correspondence between the greater plentifulness of a commodity and its depreciation never is exact, and that the value of a commodity which has become more plentiful necessarily falls before rather than after it is all sold, they declare roundly that "the issue of notes has nothing to do with their depreciation." The majority of experts did so in every European country, belligerent and neutral alike, during the war, and in many countries they do so still. Even in Germany the late President of the Reichsbank is said to have believed it to the day of his death, when the paper mark had sunk to near a billionth of the value of a gold mark.

He could not have thought so, if he had borne in mind that the issue of trillions of paper marks had meant the expenditure of trillions of marks in the purchase of commodities and services; and we shall all be spared many similar delusions if we continually ask ourselves, "How does this affect the spending of money?"

With this preface let us look more narrowly at this matter of control. Let any reader ask himself what he would do if the State were foolish enough to give him power to print and spend or lend as many Currency Notes, "legal tender for any amount," as he pleased. He would begin with small amounts, distrustful at first of his new and amazing power. Finding the thing work, he would issue more, and trade would boom. Then he would find every possible reason, good and bad, for saying that it was not his action that was raising prices. "There is," he would say, "a revival of trade (shown to be due by the relation between wholesale and retail prices), and it is caused by the good industrial policy which the newspapers which I subsidize have advocated. This is causing a legitimate demand for currency, and my issue is only just satisfying it. I am not *forcing* my currency on anyone. People accept it gladly when I buy from them, and the demand by borrowers is so enormous that my fifteen printing works can scarcely turn out enough notes. Surely you would not have me penalize industry and damp down the revival by charging six per cent.? What have you to complain of?" In this case I think every one will agree that control could best be exercised by taking away our reader's power to create currency rather than by watching and controlling his creation of credit.

So far as I know, no such power has ever been given to a private individual. It was, however, in one famous historical case given to a body of private persons, the Governor and Company of the Bank of England, during the Napoleonic struggle, and I dare say that it has been given to similar corporations in various countries since 1914, but information on such subjects is curiously deficient. The Bank of England acted just as we have supposed the individual would act, except that it moved more slowly, and, being a corporation which never dies, it had more regard for the future, and was therefore kept in check to a great extent by the probability that it would be asked in a few years to redeem its notes in gold. There is no reason to suppose that any corporation of shareholders working for profit would act differently. It is sometimes thought that a bank is in a fundamentally different position from an individual, inasmuch as it is the business of the bank to lend, and it is supposed to be less tempting to print notes to lend than to print them to spend. This is clearly wrong if the interest of the fleeting shareholders

is thought of. The shareholder can expend his dividends on buying land, houses, and other property, so that if he gets great amounts now he need not fear a lean future. But there is some force in the notion, all the same. The bank as a corporation, if it confines itself entirely or principally to monetary obligations, will have an interest in not depreciating these obligations, and so, if its managers, working for the institution rather than the shareholders, are enlightened and able to disregard the shareholders, they will not create enough currency to depreciate it. They will refuse to lend at a rate low enough to take out more and more notes, and perhaps somebody may like to call this "control of the creation of credit," though it is more natural to call it control of the creation of currency.

But the probability is that in very few countries these managers would be enlightened and firm enough. Elsewhere they would yield to pressure, and notes would gradually leak out. The obvious way for the community to stop the rot would be to take away the bank's power of creating inexpensive legal tender. But this again would be controlling the creation of currency rather than the creation of credit.

Very naturally, the grossest cases of depreciation of currency have occurred where Governments have reserved to themselves such gains as were to be got by it, either by manufacturing the inexpensive legal tender themselves, or by giving the power to a State bank which is bound by some arrangement to hand over the profits of the issue. The second is the commonest method and also at present the most prominent, as it was adopted by Germany. Under it, being able to borrow from the State bank without paying any interest (since, if it does nominally pay, it recovers the amount immediately), the Government does so borrow. The bank must issue more notes to satisfy this demand for money, the notes depreciate, so that the Government has to borrow more, and still more, and more and more as the depreciation increases at a more and more rapid rate. The well-disposed foreigner, looking on from afar, adjures the Government to "balance its budget," meaning not what is conveyed by the words in their strict sense, but merely "make ends meet without resorting to this fictitious borrowing, which is only in reality the printing of notes." The Government says plaintively that it cannot, because the depreciation is so rapid that taxes cannot

be made to keep up with it, though expenses rise faster, and nobody will help with a loan. Sooner or later, however, the situation becomes understood, even if only dimly, by the people of the country itself, and then the Government is obliged to accomplish the absolutely impossible and "stop the printing-press." Once more the creation of currency is controlled, and the "creation of credit follows suit." I scarcely think anyone will allege that what was wanted in Germany was control of credit: obviously the real need was for control of currency. Could the German Government have been stopped from borrowing by interest of 1,000 per cent. per day, so long as that interest was immediately recoverable from the bank?

No reader of Mr. Keynes' book will have any difficulty in seeing the beam in Germany's eye: we all recommended her to pluck it out. But it is much more difficult, apparently, for us to see the comparative mote in our own eye, and I doubt if one reader in a thousand of those who will receive Mr. Keynes' gospel gladly will realize that what is sauce for the goose is sauce for the gander, so that "balance your budget" is as good a maxim in London as it is in Berlin.

Yet no fact of elementary arithmetic is more certain than that when more Currency Notes are issued than are cancelled, the British Government's capacity to dispense with taxes and borrowing at interest in the ordinary way is increased, and when more are cancelled than are issued, its capacity to dispense with taxes and borrowing is diminished. The fact is concealed from the public by the existence of the peculiar bank of issue set up under the Currency and Bank Notes Act, 1914, called the "Currency Note Account." At the beginning of the war, confronted with want of an emergency currency, the State might have permitted the existing Issue Department of the Bank of England to issue small notes and increase its fiduciary issue beyond the limit allowed by the Bank Charter Act. Instead of that, and without in the least foreseeing the enormous consequences, it empowered the Treasury to issue £1 and 10*s*. notes and to issue them *ad libitum*. Whatever the Act may have intended, the Currency Note Account became a "Government Department" under the Treasury, though located at the Bank of England, and issues notes to the Bank of England alone in exchange for coin, Bank of England notes, and simple credit in the books of the Bank.

The coin and bank-notes it keeps in reserve "against" the issue, and the credit it draws out and "invests in Government securities," which in practice means Treasury Bills and "Government Department Ways and Means Advances."[1] That is, the issue has made the Government able to dispense with taxes and loans and all other receipts to the extent of the whole issue minus the part covered by coin and bank-notes. To that extent the United Kingdom has not "balanced its budget" in the sense in which that phrase is used in regard to Germany and other countries.

The fact is little recognized because successive Chancellors of the Exchequer have resolutely refused to let the amount appear in the national accounts, as it would do if the Treasury Bills held by the Currency Note Account were shown separately from those held by banks and others, and if the Ways and Means Advances obtained from the Account were separated from those obtained from the Savings Bank and other "Government Departments." It is further obscured by the fact that the Bank of England refuses to hold any reserve of Currency Notes. It receives them from its customers, and pays them out to anyone who has a right to ask it for "pounds sterling" and does not want Bank of England notes, but it alone of all the banks in the country keeps no store or reserve of the principal currency used by the inhabitants. When a Currency Note is paid in over the counter, it is promptly carried to the Currency Note Account Department, and paid in there. Then the balance held by that fictitious person (in reality the Government itself) is debited by

[1] Mr. Keynes seems to have forgotten this when he writes on p. 181: "A change in the amount of what the Treasury borrows from the Currency Note Reserve is reflected by a corresponding change in the opposite sense in what it borrows in Ways and Means Advances or in Treasury Bills." Apparently this should read: "A change in the amount of what the Treasury borrows from the Currency Note Account is reflected by a corresponding change in the opposite sense in what it borrows in Ways and Means Advances and Treasury Bills not advanced by or taken up by the Currency Note Account itself." But even then it would be quite incorrect: it implies that all the money raised by issuing notes is necessarily utilized to pay off other floating debt, which is palpably not the case; there is nothing to show that the fact that £230,000,000 have been raised by the Currency Note issue has caused the other floating debt to be that much less than it would otherwise have been.

the amount of the note. Conversely, when a customer or other person who has a right to demand pounds from the Bank asks for Currency Notes, they are fetched from the department, and the Account's balance is credited with the amount. So each Wednesday when the Bank Return is published, never a Currency Note is to be seen in it, though half a dozen millions may have passed in and out of the Bank in the week. The result of this practice is that seasonal and other fluctuations in the amount of currency which the other banks and the public find it convenient to keep in their tills and pockets are no longer, as they were in pre-war times, made very obvious by reciprocal fluctuations in the Bank's reserve. They appear instead in corresponding fluctuations in the amount of Currency Notes outstanding. At the beginning of the summer holidays, for instance, large numbers of people are known by their banks to be about to want to hold unusually large pocketfuls of cash because they will have to pay for railway tickets and other things for which cheques are not taken. To meet their demands, their banks draw on their own balances at the Bank of England, taking out sufficient cash for the purpose. Before the war this action pulled on the Bank of England's gold: now it pulls on the Currency Note issue, and increases the amount of that issue outstanding. Hence superficial observers are very naturally led to believe that notes are issued and cancelled as required by "the legitimate demands of the public," and to overlook altogether the much more important continuous pull outward or inward exerted all the time by Treasury policy.

Down to 1920 this pull was outward, but in December, 1919, the Treasury, by the adoption of the Cunliffe limit, undertook not to increase the fiduciary issue beyond its amount at that time, and the outward pull disappeared in the fiscal year 1920–1. In the next two fiscal years there was a strong pull inwards, but this seems to have ceased with the beginning of 1923–4.

There is no mystery whatever about the nature and working of the Treasury pull. The complications of the Currency Note Account only cover its nakedness with a very transparent veil. If the agent of some spending department of the Government arrived at the Bank of England to-morrow with a properly drawn cheque for forty-five millions and asked to have it in pound notes, the Cunliffe limit would present an obstacle. But

if that limit were out of the way, the Bank would find no financial difficulty in handing out the notes as soon as they could be printed. Let us then suppose that the Government agent gives the notes away as Easter eggs to every man, woman and child in the country, or that he buys all sorts of things for the Government, or pays for services rendered to the Government. Prices will obviously be raised by the expenditure of this additional money, or rather by the expectation of it, as soon as the fact that it is going to take place becomes known: prices being higher, the stocks of money which people require to keep for convenience will be higher, and so the notes once issued will remain out—they will *not* be paid back by the recipients into their banks and by those banks into the Bank of England.

Of course in real life the Government does not send its agents with cheques to draw notes over the counter from the Bank. But the effects are just the same if it pays the cheques away to all sorts of persons up and down the country, who thereupon pay these cheques into their own accounts with their own banks and subsequently draw out and spend the money. The fact that it is known that the Government is going to spend forty-five million pounds more without making anyone else spend forty-five million (or any) pounds less inevitably raises prices and pulls out and keeps out the extra currency.

Conversely of the inward pull. If the Government were to put on a special tax or raise a special loan for the purpose of redeeming Currency Notes, while otherwise "balancing its budget," anyone can see that the notes could easily be got and put in the fire, and that prices would be lower because money-spending power [1] was taken away from the persons who paid the extra tax or subscribed the extra loan *without* being balanced by extra money-spending exercised by the Government. But exactly the same result follows when, without any special tax

[1] May I plead for the introduction of the term "money-spending power" in place of the usual "purchasing power"? "Purchasing power" should be used only in the sense in which it is measured by quantity of commodities purchasable. To use it also in a sense in which it is measured by the quantity of money spendable is confusing. It is, for example, very confusing to say that the purchasing power of the German people was increased when they had trillions of marks to buy with; to say that their mark-spending or money-spending power was increased is lucid enough.

or loan being raised, the money raised by the Government (otherwise than by issue of notes) does in fact exceed the expenditure (other than in redemption of notes). In the absence of a Government currency, excess of receipts over expenditure would simply mean to the Government, as it does to an individual, an increase of bank balance. As things are, it means notes received by the Bank, and (instead of being held to the credit of the Government) paid into the Currency Note Account and there cancelled.

The truth on this matter is confused by two doctrines which accept the idea that the Treasury can pull the notes in or out, but teach either (1) that the pull is only exercised by the balance of taxes over or under expenditure, or (2) that it is only exercised by the balance of taxes *plus* money raised by non-floating debt over or under expenditure. Both these doctrines are wrong.

(1) The first is wrong because the money-spending power of the people is diminished when the State borrows from them in order to spend the money borrowed in buying up and cancelling currency just as much as when it raises the same amount for the same purpose by taxes. It is true that when the State borrows, it promises to pay interest in the future, so that the individual lender feels himself better off than if the same amount had been taken from him in taxation; but the whole of the people taken together have no right to any such feeling, inasmuch as the future receipt of interest will be balanced, and a little more than balanced, by the additional taxation required to pay the interest and cost of collection. It is true that the amount borrowed will be more entirely derived from the savings of individuals than an equal amount derived from taxes, but this too makes no difference for the purpose in hand, since the investment of savings means money-expenditure just as much as does expenditure for consumption. The difference between consumption and investment is not that the one means more money spent than the other, but that investment means that the expenditure goes to additional equipment in machinery, houses, etc., and consumption does not. But if the State borrows money from its subjects to redeem and cancel currency, less money will be spent and prices will tend to fall.

(2) The second doctrine is almost obviously wrong, because there is no distinction between "floating" and other debt, except

that the floating debt is renewable at earlier dates than the other, and is, in fact, constantly being repaid and renewed by fresh borrowing. "Floating" or not floating is only a question of degree, not of principle, and in fact the distinction in practice is perfectly arbitrary, traditional and unimportant. The debt held at shortest notice and most frequently repaid and renewed is the very large amount of money owed by the State to the Savings Bank depositors, and this is seldom or never thought of as part of the floating debt at all. The only reasons ever given for making a distinction between the floating and non-floating debt for the purpose in hand seem to be two: (*a*) first, that possession of Treasury bills enables the holder, if he pleases, to ask for cash when the bill falls due, and (*b*) second, that the possession of Treasury bills enables the holders to "create credit," so that the people's money-spending power is increased when more Treasury bills are issued, and diminished when the amount of them is reduced.

(*a*) The first of these reasons is very easily disposed of. No doubt the banks could, if they chose, insist on having Currency Notes when their Treasury bills fall due, but in fact they don't, any more than the Savings Bank depositors with one accord go to the post offices and demand their deposits in cash all at once. Why should they, so long as the Treasury is willing to re-borrow at a rate which makes the new bills profitable for the banks to hold? And if the banks were suddenly seized with a desire to throw profit to the winds and wreck the State, would it be impossible for the Government to get the required notes without printing additional ones? After all, the amount of bills falling due at any one time is not so very large, and presumably about a quarter of them are not held by the banks but by the Government itself in the Currency Note Account and some more by other Government departments. With the assistance of the Bank of England and the individual loyal holders of balances in the other banks, the Government could quite easily beat off this incredible attack. Those who have imagination to conjure up such an attack should also be able to conceive defensive measures. The Government could announce an issue of 8 per cent. three-year Exchequer Bonds, the amount to be subscribed at once in Currency Notes only, handed over the counter at the Bank of England or sent by post: the list to remain open till the chairmen

of the Big Five appeared on the steps of the Treasury dressed in white sheets and prepared to kiss the toe of the boot of the Financial Secretary. The list would soon be closed; for the banks are liable to pay their customers on demand at least ten times as much legal tender money as the Government and the Bank of England are liable to pay the banks at any one moment. Those who live in glass houses cannot afford to throw stones.

(*b*) The other reason is a little more difficult to deal with in consequence of the wide prevalence of the very curious delusion that when a bank lends money on Treasury bills to the Government, this enables it to lend more money to other borrowers, so that the more money the Government borrows in that way, the more the banks can lend to their customers, with the result that these customers will spend more money, which will raise prices and draw out notes because the higher price-level requires a larger holding of notes by each individual and institution. Conversely, it is supposed that when the Government reduces the Treasury bills outstanding by paying some off without issuing an equal quantity of new ones, it cuts down the ability of the banks to lend to their customers, diminishes those customers' money-spending, lowers prices, and pulls notes into the Bank of England, which pays them in for cancellation.

It may seem quite incredible that anyone can really believe that when a Government borrows money from a person or body of persons (whether called a "bank" or not), that person or body is thereby rendered *more* able to lend money to other borrowers; and conversely, that when the Government repays what it has borrowed, the repaid creditor is rendered by the fact of repayment *less* able to lend to other borrowers. Yet that this has been believed in the very highest circle of British financiers, at any rate not very long ago, is nearly proved by the fact that Mr. Austen Chamberlain, when Chancellor of the Exchequer, with access to all the best advice, complained pathetically that the more he repaid the banks what they had lent during the war, the more they lent to their customers.[1] He had evidently been told that if he repaid the banks they would be able to lend *less* in other directions, and had imagined it to be true.

To argue against such an absolutely groundless delusion is unnecessary, but it may perhaps be useful to explain that it

[1] See above, p. 225.

arises out of the topsy-turvy conception of banking which has unfortunately become fashionable in recent years. In the older and juster view bankers appeared to be intermediaries or middlemen between lenders and borrowers: they re-lent what was lent to them, keeping some cash in hand on all ordinary occasions in order that they might be in no danger of not being able to meet any demand that their creditors might make on them (these creditors being mostly entitled to be paid on demand). In the modern view, popularized in this country by Mr. Hartley Withers, and adopted by Mr. Keynes (pp. 178–81), the large share of the whole valuable property of the community possessed by the holders of credit balances at the banks is completely ignored. The bankers are thought of as having (by some means which is left in considerable obscurity) got hold of a certain amount of cash, and then, apparently because there is some magic in calling yourself a banker, being able to "create" eight or ten times as much "money" or "deposit-currency." According to this view Treasury bills somehow drop into the banks without being paid for, and consequently without reducing the banks' resources at all; and once there, as they are "cash at one remove," they enable the banks to "create more credit," and thereby increase the money-spending of the people and raise the level of prices and draw out notes. This, of course, is all moonshine: every practical banker knows that he is not a creator of credit or money or anything else, but a person who facilitates the lending of resources by the people who have them to those who can use them.

The conclusion is that in this country as well as in all other countries, now and always, it is the issuer of inexpensive legal tender currency who has the control of its amount and consequently of its purchasing power; that here and now the Government is this issuer; and that it actually (though very likely without Chancellors of the Exchequer being aware of the fact) exercises its power of control by its policy with regard to total receipts and payments. If it raises from all sources except the issue of notes more than enough to pay all expenses (including repayment of debt), notes will be redeemed and the amount outstanding reduced. If it raises less than enough, additional notes will be issued and the amount outstanding increased. And by this control of currency the Treasury ultimately controls prices.

The importance of the Cunliffe limit, pooh-poohed by Mr. Keynes, depends entirely on the action of the Government in making ends meet. If it insisted on allowing expenses to exceed receipts, it would doubtless withdraw the Minute adopting the limit. If, on the other hand, it makes receipts exceed expenses, it can keep as far below the limit as it likes, and there will be no chance for the limit to " become operative." It is only " actually operative " when the Government keeps receipts equal to or in excess of expenses because the limit is there rather than for other reasons. Mr. Keynes says (pp. 183–4) that the limit has never been actually operative, but it is difficult to believe it could ever under any circumstances be more actually operative than it was in 1920. To ask, as Mr. Keynes does, for its removal at a time when a considerable diminution of the currency is urgently required to prevent a fall in its power to buy not only gold but also other commodities in general, seems ill-judged on the part of an authority who desires stability of prices.

It will perhaps be said that Mr. Keynes' rejection of currency limitation in favour of credit limitation is an *obiter dictum* unnecessary for his main purpose, which is to urge that we should continue to use a paper standard, but should regulate its value so as to keep it stable in purchasing power over commodities, allowing gold and foreign exchanges to go hang. Whether this would be desirable or not depends on our estimation of a number of probabilities, such as the likelihood (very small surely) of many other countries adopting the paper standard arrived at by the Government of Great Britain and Northern Ireland, and the possibilities of great changes in the productiveness of gold-producing. But before discussing whether we should make our pound stable in terms of commodities or in terms of dollars or gold, we may as well make sure that we know how to do it. We shall certainly make a mess of any scheme of regulation if we refuse to face the elementary fact that currency is no exception to the general theory of value, but, like other things, is cheapened by increased supply and made dearer by increased demand, or if we blind ourselves to the fact that the British Treasury is the only body which can supply Currency Notes and which can afford to burn them, or finally, if we imagine that under existing circumstances it is anything but the will of the Treasury to raise money in other ways which determines whether

any fiscal year shall end with more or with less Currency Notes outstanding than it began.

VI

RECENT IMPROVEMENTS IN MONETARY THEORY

[An address opening the discussion on Monetary Reform at the Annual Meeting of the Royal Economic Society on April 14, reported in the *Economic Journal* for June, 1924.]

HAVING been recently accused of believing that the last word in monetary theory was said in the elementary textbooks of years ago, I have been trying to discover what these textbooks really did say. In the course of this research I came across, in Walker's *Political Economy* (p. 128 in edition of 1892), a passage which shows at any rate the unchanging character of monetary theorists. He says: "Men who are candid and even liberal in politics or religion become furiously or stupidly fanatical as soon as their views on money are controverted," and recalls that Sir Walter Scott makes one monetary theorist write to another, "In your ill-advised tract you have shown yourself as irritable as Balaam and as obstinate as his ass."

For to-day, at any rate, I mean to endeavour to conceal my furious or stupid fanaticism, and to dwell rather on the general improvement which has taken place, chiefly in consequence of recent experience, in the views of experts, rather than on the points on which they differ.

The improvement which has taken place may be shortly summarized in the statement that the relation between the quantity of currency and its purchasing power has been cleared up. There is no denying, I think, that the textbooks of years ago—not only the elementary ones—gave a very muddled, unsatisfactory account of this relationship. They asked us to think of the whole quantity of money in existence being offered in exchange for a total of commodities (and perhaps services) of which it was impossible to form any definite conception—it was not the total in existence nor the annual or weekly production nor any other total with which we are familiar. Then it was taken for granted that we should infer that the purchasing power

of the money would depend on the relative variations in magnitude of the two totals, so that if the money increased while the commodities remained stationary, the purchasing power would fall. After that it was admitted that a modification was necessary because the same piece of money could be exchanged for goods more than once. To meet this it was said that the purchasing power of money depended not only on its quantity but also on its rapidity of circulation. Nothing, as a recent writer has pointed out, was said about the possibility of a commodity being exchanged for money more than once. The doctrine never carried conviction to the ordinary intelligence, and never will, even if much more carefully re-stated.

It has now been entirely scrapped, and we are asked to look at the matter in a much simpler way. Currency is regarded like any other durable goods, such as ships or houses, which form part of the material equipment or capital of the community. We start from its value or purchasing power as we find it at any moment, and then ask ourselves how that will be affected by changes in the supply of and the demand for currency, thinking of the supply and demand just as we think of them in regard to houses, the supply being the whole stock in existence, and the demand being furnished by people who want to hold portions of that stock.

The supply side of the matter is simple enough. Additions to the stock tend to diminish the value of the unit of currency just as additions to the stock of houses tend to diminish the value of the unit of housing. They have to be put on the market by the issuer himself or by some one to whom he lends them, and in either case this means more units of currency spent in buying commodities and services; and more spending, in the absence of increase in commodities and services, means higher prices, which is the same thing as diminished purchasing power of money.

The violent experiences of recent years have not only given us plenty of examples of this far more striking than any which were available to the writers of the textbooks of years ago, but have completely cleared away a difficulty which was often felt, and that too even after the war had been proceeding for some time. This is the fact that a rise of prices attibuted to increase of currency was often found on careful inquiry to have preceded

that increase. The unbeliever naturally adopted the converse of *post hoc ergo propter hoc*, and argued *ante hoc, ergo non propter hoc*, and even alleged that the rise of prices, which he usually ascribed to some quite impossible cause, compelled or called for the increase of currency, instead of being occasioned by it. Nowadays we can see that there is nothing more anomalous in people putting the value of money down some time before an additional issue is made than there is in their putting the value of cotton or wheat down some time before a plentiful harvest. In matters of prices man looks before rather than after. An expected change of prices causes prices to change at once: it is not in the least necessary that the public should have clear or correct opinions about the cause of the rise, but only that they should expect it.

On the demand side the experience of recent years has been even more useful than on the supply side. The old plan was to represent the demand for currency as coming from the people who wanted to sell goods, as if these people wanted money to eat instead of merely as a means for getting other goods or services in exchange. Attention was directed to the quantity of money in actual circulation or passing from hand to hand, in entire forgetfulness of the impossibility of assigning any magnitude whatever to the amount passing at a point of time, a *point* having itself, as Euclid says, neither parts nor magnitude. The amount passed in a day or a week would have a meaning, but the amount passing at a given moment had none. All this is now completly changed. Hoarders, defined by Mill as persons who keep money in reserve for contingencies which do not occur, and also the much more numerous persons who keep money in reserve for contingencies which *do* occur, are in the modern view the real demanders of currency, just as the persons who want houses to live in are the real demanders of houses. There is no longer any idea of balancing all the currency against some loosely conceived total of commodities for sale, but a definite conception of each person wanting to hold a sum of currency sufficient to buy her or him (for the "house-keeping money" of the matron is greater than the pocket-money of the master) the collection of commodities and services which she or he is likely to have to pay for in cash before the next replenishment of the holding. I do not contend that this conception was

wholly unknown before the war: rummaging among old lecture notes, I find that I was teaching it orally ten years before I put it in a book in 1918. But the currency troubles of the war secured its wide acceptance by experts. They saw that currency depreciation was causing enormous increases in the amount of currency held per head of inhabitants in different countries, while at the same time the purchasing power of this increased holding was greatly reduced. The average German's holding of marks, for example, would increase from, say, 100 marks to 1,000,000 marks, and yet (owing to the depreciation) this holding would only buy him a collection of commodities about, say, one-tenth as large as the old 100 marks used to buy him. Then the experts would infer, quite justly, that this collection must be far too small for convenience, so that if the fear of further depreciation could by any means be allayed, the holders of currency would try to enlarge their holdings, which would reduce prices if no more currency was printed, or absorb a large amount of new issue without any rise of prices if the press was allowed to go on for a time. This line of argument, which was perfectly borne out as time went on by actual experience, is obviously founded on a basis of looking to holders of currency for the intensification and extension of demand for currency.

Nothing nowadays can be regarded as properly received into the economic church till it has been duly christened after some letter of the alphabet, so we may note that the collection of commodities commanded by the holdings of currency has been named k in Mr. Keynes' restatement of the quantity theory in his equation,

$$n = pk,$$

k being doubtless chosen not for any personal reasons but because it is the same thing as a hard c, and c (which *I* might for personal reasons prefer) for Collection of Commodities Commanded might be confused with c for Cash or Currency. Mr. Keynes' n stands for the total of currency and p for price-level, so that the equation enshrines the truism that the total of currency equals the money-value of what can be bought with all the holdings of which it consists.

The importance of the new idea lies not in this truism, but in the clearer light which it throws upon causes of appreciation and

depreciation of money. Those who used the old apparatus, if they recognized that increasing hoards tended to appreciation, had to regard the increase as tending to diminish the supply or quantity of money, in spite of the fact that every one thinks of the quantity as being shown by the amount outstanding, no matter whether that is held by hoarders or others: it is much simpler to think of the hoarder, along with any other holder who is increasing his stock of currency, as demanding more currency.

Again, the old apparatus was very unsatisfactory in relation to the effect of increased banking facilities. Such facilities were supposed quite rightly to "economize" money, and so to tend to reduce its value, but how they did it was left in great obscurity. The "use" or employment of money was supposed to be diminished, but why that diminished its purchasing power was unexplained. With the new apparatus we can see at once that the advent of a bank in a place formerly twenty miles away from a bank will straightway diminish the demand for currency by causing the holders in the place to be content with smaller holdings than before, while the bank's holding, kept at the command of the customers, will be much less than enough to counterbalance this.

To give one more example, the old apparatus was quite insufficient as an equipment for anyone who wanted to explain the enormous divergencies between the rates of increase of currency and the rates of depreciation which we have seen in recent years. With the aid of the new conception we can attribute them with ease and certainty to the varying fears and hopes of holders of currency, which lead them to try to reduce their holdings to the lowest possible point at one time and to increase them largely at another.

All this improvement, by clearing away difficulties about the relation between quantity of currency and prices, makes it far easier than it was before the war to see that for the maintenance of the value or purchasing power of a currency limitation of supply is essential.

It was for want of our experience that the pre-war theorists never made it plain to the public that the value of their currency was actually kept up by strict limitation of supply. Gold, it is true, could be turned into coin in unlimited quantities by anyone who could get it in unlimited quantities, but nobody could do

that; there was a limited quantity above ground, and nobody could get more out except slowly and at considerable cost. Paper currency existed, but was limited by various regulations, and over and above those regulations, by convertibility, to the amount which could circulate without falling below the value of the gold it promised to pay. But that the virtue of limitation was not clearly grasped is shown by the persistence with which textbooks continued to assert that the value of our token coins was kept up by limitation of their legal tenderability instead of, as of course it really was and is, by the limitation of their issue to the amount which will circulate at par.

For want of recognition of the necessity of limitation, at the beginning of the war nearly all countries—most of them without the smallest excuse except a desire to be in the fashion—suspended their regulations and convertibility without instituting any other system of limitation or apparently ever thinking that any kind of limitation was necessary. The only difference between the countries was that some allowed their Central Banks to make a profit by lending the additional legal-tender inconvertible notes to private persons as well as to the Government, while others, more prudent, like the Bolshevists and the British, took care that the notes issued should buy commodities and services for the Government only.

The natural consequences followed: the issues grew and grew, and depreciated enormously, and we have not seen the end yet except in the few countries which have returned to gold.

Some limit is absolutely necessary, and the choice for all except currency cranks is between founding the limitation on some parity, old or new, with gold, and founding it on a parity with some collection of commodities such as is summed up in an index-number of prices.

Of these two principles, the second or general-price principle is naturally far more attractive to the monetary theorist as an ideal to be worked for in the future. To tie the purchasing power of money to that of a single metal, though that metal is a very fine one which would be put to an immense number of most important uses if it were less scarce than it is, has been rightly described as an expedient fit only for a barbarous age. But can anyone who has lived through the Great War have any doubt that a barbarous age is precisely what we have for the

moment to provide for? The cruder and simpler principle may suit us best for the present and immediate future. We, barbarous mankind, are still divided into suspicious and malevolent tribes, occupying territories which we regard as our tribal properties. There is not the least chance of the various nations agreeing on any uniform system of limitation of currencies by prices which would give us the stability of international exchanges which we possessed before the war. On the other hand, there is every probability of a general return to the gold principle, which would give us that stability. On this I think Mr. Keynes was unquestionably right when he said in the *Manchester Guardian Reconstruction Number* of April 20, 1922, "I see no other solution of stabilization" (international exchange stabilization, that is) "except this traditional solution—namely, a gold standard in as many countries as possible."

For the advantage of exchange stabilization we ought to be prepared to sacrifice a good deal of the other kind of stability—stability of domestic prices between one time and another. Particularly should we be ready to do so if we happen to belong to a small country with a large foreign trade and extensive financial interests outside itself.

But it is difficult to believe that we should in actual fact sacrifice *any* internal stability by readopting the "barbarous" principle of limitation by parity with gold rather than the more refined principle of limitation by general prices. The limitation by gold can be enforced by convertibility in a simple and straightforward way, as it was in the past. I am inclined to admit that the paper pound might conceivably be made convertible in a roundabout way into the large basketful of commodities which serves as the basis for an index-number of prices, but the proceeding would be complicated, unintelligible to the ordinary mind, and liable to be thrown out of gear by changes taking place while the necessary statistics were being made up. It seems to be admitted by the best exponents of the general-prices system that the necessary measures would have to be taken by anticipators rather than by clerks working on statistics collected some days or weeks ago. So long as the anticipators were honest and intelligent and anticipated correctly, things would go well, but we may be permitted to doubt whether on the whole the short-period vagaries and the long-period general biases of the

anticipators would not more than equal the short and long period fluctuations of gold.

I do not say that gold must for ever continue to be the best possible standard. I am enough of an historian not to believe in the permanence of anything. As soon as we economists have been a little more successful than we have hitherto been in getting elementary ideas into the heads of the public, it will become possible to modify the gold standard either by working on the supply of gold and the demand for it or by altering gold parity with currencies in such a way as to make the standard more stable. Such measures will have greater chance of success if they are taken by a world already on the same standard.

However that may be, one thing stands out as absolutely certain, and that is that to one or other of the two principles of limitation—limitation by the price of gold or limitation by general prices—we must soon adhere. I believe I shocked some people a little time ago by saying that it was false in the long run that "bad money drives out good," but I was perfectly right. Good money does in the end overcome bad, even when the bad is numbered by trillions. The countries which at present adopt no principle of limitation, but simply abuse the foreign speculator after selling him a great quantity of worthless paper, and then try to borrow from him, may have a long career of depreciation yet before them, but they will pull up at last. Countries like Great Britain and France which have adopted fixed and arbitrary limits bearing no relation to the prices of commodities or gold will at length come to see that though such limits when actually operative are far better than nothing, inasmuch as they prevent further depreciation beyond a certain point, yet they provide neither stability of internal prices nor stability of foreign exchanges. The recent experience of France is instructive on this point.

1925

I

DÉFLATION EN PRATIQUE ET DÉFLATION POUR RIRE

1.

[A letter to Professor Rist, who had kindly sent me his *La Déflation en pratique*, 1924. See above, pp. 283–5.]

January 18, 1925.

DEAR PROFESSOR RIST,—

. . . I am afraid we do not agree about 1920 any better than about 1820 (*Déflation*, p. 128, note 1). I have no doubt whatever that the slump of 1920 was caused by the stoppage of additions to the currency. The boom could have been maintained (as it was in Germany) by a continuance of the emission of additional paper: the adoption of the Cunliffe limit prevented this continuance and so killed the boom. And —— and —— declared that the limit could not be enforced, but there was enough expectation that it would be enforced to cause the kind of fright which used to be caused by a "drain of gold," and to compel a rapid rise in the rate of discount.

The Treasury, consciously or unconsciously, followed up the blow by purchasing and destroying, down to March, 1923, a large quantity of Currency Notes. It has often been alleged that it was purely passive in this matter, and that the notes "came in of themselves" or came in "automatically" in consequence of the fall of prices. But, in fact, they came in because the Treasury was prepared to pay the cost of burning them. I or anyone else can burn as many Currency Notes as we like, if we are prepared to give a pound's worth of goods for them, and the Treasury was and is no exception to the rule. The notes diminished because the Treasury got them in, whether by raising taxes

or by borrowing [1] does not matter. Nothing would have been easier than to have arranged the national finance so that their amount would have remained stationary: all that was required would have been to either raise less by taxes and loans or spend more while raising the same amount. The notes would then have gone out of the Bank as fast as they came in, instead of coming in faster than they went out.

After March, 1923, consciously or unconsciously, and perhaps in consequence of . . . at the beginning of 1923, the policy of reduction was abandoned in favour of keeping the amount stationary. Then in 1924 came the *reprise un peu vive des affaires* to which you look forward on p. 29. Again, some authorities . . . said the Cunliffe limit (now down to 248 millions fiduciary) "would have to go." But it did not go, nor was the limit on the Bank's issue removed, as you expected (p. 29). Instead, the limit worked as it was intended to work, and just as the old pre-war limit (imposed by convertibility into freely exportable bullion) used to work. The expected stringency compelled a rise of the Bank Rate, and both the August and the Christmas peaks were safely passed. At Christmas, it is true, £4,500,000 more in bank-Notes were paid by the Bank for an equal amount in Currency notes, but this merely amounts to an exchange by the public of 4½ millions in notes of £5 and over for 5 millions in £1 and 10*s*. notes.

It is perfectly easy to keep the currency down *provided there is a real desire to do it.*

The existence of "budgetary equilibrium" is not necessary. Before the war there were plenty of cases of sound currencies in countries which did not raise revenues sufficient to cover their expenditure. An absolutely bankrupt State can have a perfectly good currency without a trace of inflation.

. . . . .

I am afraid the notion which you describe in your letter—that if the State repays the Bank of France, prices will fall—is only the same notion which prevailed here in 1919. Great sums were paid back by our State to the banks, and as Austen Chamberlain, then Chancellor of the Exchequer, complained in the middle of

[[1] "Borrowing" is of course meant to include transferring Government securities from ownership by the Currency Note Account (a Government department) to ownership by private persons and institutions.]

March, the banks simply lent out to private persons the money which the Government repaid and the boom went merrily on. I asked in a letter to *The Times* of March 23, 1920, "what else did he expect ?" If a lender is paid off by one borrower, of course he naturally lends his money to some one else. And so it will be with the Bank of France if the limit of issue is not simultaneously reduced. This is not *déflation en pratique* but *déflation pour rire*. No bank or other institution or person will voluntarily burn legal-tender money belonging to them unless some strong pressure is put on them by the community. If France persists in the course you describe, I shall expect the franc to get considerably worse and then to be stopped from getting still worse by the existing legal limit of issue: if that is removed I shall expect it to get indefinitely worse, like the German mark in similar circumstances.

To go back to the original, and of course very minor question raised by my student—whether the fact was recognized that the French taxpayers would be making an enormous gift to the Bank of France by paying back the advances on which (he thought no interest was paid, but on which, as you explain) 0·375 interest is paid—your answer is that the gift will not really be very big, because the Bank is expected to reduce the amount of its notes. I have said above that I do not believe it will, but let us take it that I am wrong. Supposing then that it does reduce the amount of notes as much as you expect, will not the pure gift still be enormous if the whole amount of money which the Bank has been allowed to print is taken into account ? Before the war, the issue was under 6 milliards: now it is about 40, or about seven times as much. Suppose you get it reduced by one-seventh, which is about as much as you expect: the Bank will then have been given about 34 milliards for nothing except the cost of printing and renewals. Contrast this with the corresponding history of the Bank of England: during the same period the Bank of England's issue has also risen to about four times as much, but the whole of this (except the £1,300,000 increase of fiduciary issue which it obtained in pursuance of the arrangement made 80 years ago) has been given out in exchange for gold now in the strong-rooms, so that there is no profit in it but only expense of printing and renewing the notes and of keeping and guarding the gold. Of course there may be some

way by which the French Government recovers part of the gift: the figures we get here only show that the profits of the Bank of France have increased enormously, not what becomes of them except that the dividend has increased by one-half.

You ask if our Government does not pay interest on Ways and Means Advances. Yes, certainly, but the Bank has to provide the sums out of the balances left with it by its customers: it cannot provide them by the cheap and easy method of printing notes. (By the way, the very large sums of Bank's Ways and Means Advances during the war, referred to on your p. 14, middle, were not really for the most part advanced by the Bank of England, but were only specially collected by it from the other banks and passed on to the Government: the Bank called them "special deposits" and never included them in the weekly Return [see above, p. 303].

2.

[A letter in *The Times* of January 22, 1925.]

Sir,—

The telegram of January 18 from your Correspondent in Paris indicates that the tale of amazing currency blunders is not yet complete, so far at least as France is concerned. M. Herriot declares that the present statutory limit of 41 milliards for the total issue of francs shall in no circumstances be raised. This, of course, is excellent; articles cannot retain their value if their supply is unlimited, and the way to keep a currency from going down like German marks in 1923 is to refrain from issuing it without limit.

But the value of things depends on demand as well as supply, and, unfortunately, it appears that the Minister of Finance is going to do his best to nullify the good effect of restriction of supply by taking measures to reduce the demand for francs. He "has communicated to the Press some of the measures which the Government proposes to take to keep the note issue within its statutory limit of 41 milliards." Two of these proposals are given by your Correspondent.

The first is to destroy the demand of the Saar and Madagascar

altogether. These localities are to be provided with new currencies, and the 600,000,000 francs which they use at present will be "withdrawn." It is implied by the statement quoted above that the "withdrawal" will mean that these francs will be thrown on the market of the remaining area in which the franc is used, and this will, of course, have the effect of tending to reduce the value of the franc. In fact, M. Herriot proposes to keep the franc up by not issuing more than 41 milliards; and M. Clémentel neatly circumvents him by reducing the population which uses the 41 milliards!

The second proposal is to encourage the use of cheques. Now every one knows that people who have a bank account and use cheques do not want to hold nearly such large stocks of currency in their pockets and tills in proportion to their incomes and transactions as others do. The cheque system has been described in every elementary treatise on economics or money as economizing currency, i.e., reducing the demand for it. The large *per capita* holding of cash in France was commonly attributed to the small use of cheques in that country; in our own country most of us who use cheques have noticed a slight tendency to hold more cash since the increase of the stamp duty on cheques has made us think twice about drawing cheques for small amounts. And, of course, the more currency we want to hold the higher is the value of any fixed amount of it likely to be. It has been a received commonplace for several generations when gold was currency that the cheque system, like other banking facilities, tended to keep down the value or purchasing power of gold. M. Clémentel evidently knows all this, for, your Correspondent says, he "counts on the cheque to take the place of a great deal of hoarded cash." This, of course, only means that people will try to exchange some portion of their present holdings of currency for goods and services. Their effort to do so will inevitably tend to raise the price of goods and services—*alias* to depreciate the franc—just as much as an addition to the total issue. So here, again, M. Herriot's proposal to keep up the franc by maintaining the restriction on supply is to be defeated by a reduction of demand!

I do not wish to be pessimistic. I expect that M. Herriot will be successful in maintaining the present limit, and that M. Clémentel's plans for preventing the maintenance of the limit

having its proper effect will be abortive or comparatively unimportant. They are, I hope, the last of the schemes for making omelettes without breaking eggs—or, to speak more literally, for keeping the value of money up without making anyone complain that he has to give more goods or services for it than he likes.

II

"INCREASED PURCHASING POWER" AND EMPLOYMENT

[A letter of warning against the ambiguity already mentioned above, p. 378 note.]

April 23, 1925.

DEAR MR. ——

Ordinarily "purchasing power" means power to purchase commodities and services, and then it is measured by the amount of commodities and services which can be bought; but it is frequently used now to mean power *to lay out money* in purchase of commodities and services, and then it is measured not by the amount of commodities and services obtained, but by the amount of money which can be laid out. It would be much more convenient if people would abstain from using it in the second sense, and use "money-spending power" instead. When the German currency amounted to hundreds of trillions, the Germans' money-spending power had increased enormously, but their power to obtain commodities and services was little altered, and the aggregate power of the whole currency as well as that of the individual unit was much less.

In the first paragraph of your letter you mean by "purchasing power" what I call "money-spending power," but—— and the other cranks when they harp on the beneficial effects of "increased purchasing power" mix the two ideas up. The difficulty is to get them to see that if an increase of money-spending power does give a (temporary) stimulus to production, and thereby increase power to obtain commodities and services (since the more there are, the more must be sold), it does so in exactly the same way as a lowering of money wages does with a stable currency: i.e., it makes it possible to take more people into employment because they can be got to work for

less "real wages" than before. They get the same money but it will buy less, whereas with a stable currency and a lowering of money wages they get less money and can buy less: both plans are alike in easing the employment situation by giving the employed less.

I cannot help thinking that the long continuance of heavy unemployment is due largely to the insurance acts and their concomitants, which strengthen resistance to movement of every kind. The endowment of unemployment isn't made any better being called insurance: fire insurance wouldn't do if you allowed people to set their property on fire and keep it burning on condition of signing their names once a week at the insurance office.

III

KNAPP'S BUBBLE

[A review in *Economica* for June, 1925, of *The State Theory of Money*, by Georg Friedrich Knapp; abridged edition, translated by H. M. Lucas and James Bonar, 1924. Macmillan & Co. for the Royal Economic Society.]

THIS book may fairly claim to be the most obsolete work ever published by a scientific association during the lifetime of its author. The drastic experiments in currencies tried since 1914, and all the discussion to which they have given rise, have caused such great improvement in monetary theory that nearly all books on the subject published before the war have an antediluvian ring about them. If the authors or editors try to bring them up to date they only become confused. But this particular book was already long out of date when first published in German nine years before the war. Professor Knapp (as page vi tells us) gained his first impressions of currency in the summer of 1861, and had his first teaching on the subject in the following winter. He did not publish his book till forty-three years later. That was eleven years after the Herschell Indian Currency Commission had produced the report which led to the adoption of the gold exchange standard by India, and completely reformed current expert thought about money.

The putting of the English silver coinage on a sound basis in

1816 was the result, for the most part, not of design but of a happy accident, and what kept the silver coins up to their face value was not understood for nearly eighty years afterwards. The best textbooks, parrot-like, agreed in attributing the high value of the coins to the fact that they were not legal tender for more than £2, as if the absence of legal tenderability could increase the value of a coin or anything else! The fact that the old five-franc pieces in France and the old thalers in Germany maintained their face value of five francs and three marks was inconsistent with this explanation and remained a mystery unelucidated by the metaphor, "limping standard." The Indian Report and the discussion which preceded and followed it brought out clearly that the true reason for such coins keeping at par, though the metal of which they were composed would not fetch so much, was the same as that for every other commodity having the value which it actually commands, namely, that there is a demand, and the supply is limited to what will satisfy that demand at the price. The Indian experience which followed on the adoption of the principles of the report fully confirmed the theory.

But pages 246–7 show that in 1905 Professor Knapp knew nothing whatever of the Indian discussion and experience. To him it seemed only a "common error" to suppose "that it is necessary to limit the production of accessory kinds of money (as, for example, thalers or silver coins in Germany) in order that they should maintain their face value." If, he says, the limitation were removed, the value of these coins would not change, but, "if convertibility were maintained, there would be a great rush to convert them," and "if the convertibility were abolished," the coins would be paid to the State in large quantities in taxes, etc., and the State would not like to pay them out again to people who would rather receive other kinds of money, "so that the State pay offices would not know what to do with their superfluity of accessory money. This is very embarrassing for the State, but it has no consequences for the quotation of the thaler; that is determined by fiat, not by trade" (p. 177).

This argument is almost charming in its *naïveté*. By the same reasoning it could be shown that limitation of supply is not necessary for the maintenance of the value of anything. We have only to create a buyer or recipient who is willing and able to accept any amount at a price fixed by him, and the price will

then be fixed by fiat and not by trade. The only trouble is that when the thing can be profitably produced in large quantities at or below the price so fixed, the ability and willingness of the buyer or recipient break down, and the necessity of limitation of supply to the maintenance of value becomes painfully obvious. Professor Knapp himself, in other places in the book (pp. 192–3, 290), admits that the way out of the "embarrassing" situation in which the State will find itself is to limit the creation of such kinds of money. So that limitation, driven out by the front door, soon finds its way in again by the back.

A writer who had failed so signally in regard to subsidiary currency to apprehend one of the two essential conditions of value was not likely to say anything useful about standard money. All the fairly intelligent discussions of the advantages and disadvantages of bimetallism went for nothing with him. He did not think of the advocates of the gold standard, the silver standard, and the double standard as having even bad reasons for the faiths that were in them. To him they were all alike, simply blind men who were in the habit of reckoning values in one way and could not believe there was any other. They were alike in being "metallists" who thought a paper standard a "degenerate" form of money (p. 2). It never struck him that the real objection to paper standards was not their absolute degeneracy but their constant tendency to degenerate in purchasing power.

That tendency, apparently, even if he had recognized it, would not have troubled him at all. He seems to have despised stability as a trifling matter unworthy of the attention of a monetary theorist. "For internal trade, excluding the bullion business, the choice of the standard hardly matters at all, since it only produces secondary effects which vanish in the general welter of continuous price changes. . . . The effects of the change in standard are quite negligible, whether the change is down or up" (pp. 209–11).

Why, we begin to wonder, do countries ever change their standards? Not, says Professor Knapp, for any reasons of internal convenience, but in order to secure stability of exchange between their own and some foreign currency or currencies. England had a gold standard, and other countries adopted it to secure stable exchange with England, or later, with the gold block of which England had been the nucleus. But how, then, account for the

English gold standard? Professor Knapp, like the preacher, looks the difficulty in the face and passes it by. "England's reasons for going over to the gold standard have never been fully explained" (p. 277). Could he not take a hint from the old elementary summaries of the reasons why the precious metals were used as money, and reflect that as gold surpassed silver in the matter of having "great value in small bulk," convenience explains its permanent retention in the position in which it had been placed by a happy accident of misrating?

That Professor Knapp should hold that the gold standard was generally adopted in order to stabilize foreign exchanges seems curious in view of the fact that his conception of the theory of international exchange belongs to the darkest age of mercantilism, and leads him to doubt whether stabilization is in fact inevitably secured by the existence of a common standard. The exchanges in his view are regulated by the balance of international payments—an elusive idea which, in spite of his general *flair* for definition, he leaves quite undefined. Even when countries have the same metallic standard, enforce convertibility, and allow coins and bullion to be carried freely from one to another, it requires, according to him, something much more subtle than mere sound banking to keep the exchange within bounds, and he doubts whether in times of real strain it can always be done; in other words, he has the vulgar terror expressed in the cry, "All our gold will be drained away." Never do we find the least trace of comprehension of the fact that the price which it is worth while to give in country A for the currency of country B must in the long run depend on how much the currency of A will buy in A compared with how much the currency of B will buy in B. It was not changes in "the balance of payments" which made 20½ German marks equal in value to an English pound in 1913, 20 billions in 1923, and 20 in 1924, but the fact that relative changes in the supplies of marks and pounds caused their relative purchasing power to alter. Yet Professor Knapp, after saying, "The question how many marks the pound sterling is worth in Berlin depends on the balancing of supply and demand," which in a sense is true enough, goes on, "Supply and demand arise from unsettled business obligations and speculation" (p. 221), and in an amazing paragraph later on he refuses to discuss the question whether, when there is a lapse

from parity between two gold standard countries, the exportation of gold from the one to the other tends to restore the parity by diminishing the currency in the first country and increasing it in the second. "Such an idea," he says, "is vulgar ignorance" (p. 257).

The reader may ask, "If this book has no merits, how did it manage to get into four editions in Germany and win high praise from some eminent English critics?" It may be suggested, in answer to the first question, that the dates of the second, third, and fourth editions (1918, 1921, and 1923) fall within a period when bewildered Germans might be expected to rush to almost any book on currency; and, further, that the German book is a great deal bigger than the abridged translation now under review. A considerable historical portion has been altogether omitted, and even the purely theoretical part has been cut down. A book which is fundamentally unsound naturally suffers when deprived of its illustrations and shortened in its argument.

The answer to the second part of the question perhaps lies in the facility with which plain definition of invented terms can be mistaken for sound theory. On the average, in every five pages of the shortened edition Professor Knapp produces a new word, and each time he cackles so vigorously that the reader is apt to feel the kind of exhilaration given by the sounds of a prosperous poultry yard. But we are really no nearer a clear understanding of currency questions when we have, for example, called the re-establishment of an old standard a *restoratory* change, or when we have re-christened "free coinage" by the name of *hylolepsy*.

At the Council of the Royal Economic Society which decided to undertake the translation it was remarked by a member that the best way to destroy the influence of a bad German book was to translate it into good English. That has been done with great success in this instance, and the translators are to be congratulated. There are very few examples of "translators' English" in their work. We may only regret that they did not put on the last ha'porth of tar by adding an English index. There is an index of "technical terms," but as these are mostly the new inventions of the author, it is chiefly an index in an unknown tongue. An index in English would have made it easier to bring together the author's contradictions and inconsistencies.

In the preface to the 1905 edition Professor Knapp said that he

had given up any "attempt to influence public men" and had allotted "the first place to the theory or philosophy of the subject." He will not mind if anyone says that his "aim has been to discover the soul of money." On page 2, he says "the soul of currency is not in the material of the pieces but in the legal ordinances which regulate their use." Most of us do not worry much about the soul of money. What we want is that our money shall have sufficient body to buy as much goods and services as we gave for it. The mediaeval schoolman said that a thousand souls could dance without inconvenience on the point of a needle: counters passing for a billion marks were lately squeezed into the space formerly occupied by one mark, but not without considerable inconvenience arising from the necessary diminution of the magnitude of the mark as reckoned by its purchasing power. Professor Knapp's attempt to show that the soul of money is breathed into it by the State helped to divert attention from the fact that the value or purchasing power of the mark, pound, or other unit of account is affected by the supply of counters which pass for that unit. This is made all the sadder by the fact that in practice he approved of a gold standard. "Nothing is further from our wishes than to seem to recommend paper money pure and simple. . . . It is well for any State to wish to keep to specie money and to have the power to do so. And I know no reason why, under normal circumstances, we should depart from the gold standard" (p. 1).

IV

THE BRITISH GOLD STANDARD RESTORED

[An article in *The Times Trade and Engineering Supplement, International Banking Section*, May 23, 1925. The Budget speech was made on April 28.]

THE return of Great Britain to the gold standard announced in Mr. Churchill's Budget speech is only an inevitable step in the general restoration of that standard which has been taking place in the western world during the last three years. The number of countries which had gone so far as to keep the value of their currency units very close to that of a definite amount of

gold was already large. It included Sweden, Holland, Switzerland, Austria, Germany, Poland, Latvia, Lithuania, and Russia; Mexico and several other Central and South American republics, the United States and Canada; South Africa, Australia, and New Zealand. Few of these countries, it is true, had yet made the unit freely convertible into gold and established freedom in the importation and exportation of gold coin and bullion, but they all aspired to do so, and many of them were only holding back till Great Britain gave the lead. The tendency is unmistakable. Those who fight against it are on the losing side.

They are also on the wrong side. Whatever may be the future of money, the restoration of the gold standard is necessary and desirable at the present moment.

One of the few economic propositions which is beyond all dispute and is accepted not only by every professional economist, but also by every business man, is that the more there is of a thing on the market, the smaller the value which can be got for it. If more wheat issues from the cornfields or more coal from the mines, or if more houses or ships are built, the value of wheat, coal, houses, or ships tends to fall as compared with that of other things which are available only in the same quantities as before. Money is no exception to the rule; if more of the coins or paper notes which pass for pounds, francs, or marks are struck off and put on the market by being paid out in exchange for goods and services, the value or purchasing power of pounds, francs, or marks will tend to fall.

This almost self-evident truth is only doubted by those who fail to see that additions to currency can "get into circulation" in no other way than by being offered and paid in exchange for goods and services. If the issuing authority does not itself spend the additional currency, but lends it, it will all the same be spent on goods and services, since borrowers do not borrow money to store it up but to get either goods or services with it. The additional money spent naturally raises prices, and the curious delusion of some cranks who believe that the printing and spending of more money will cause an equal increase of goods and services is sufficiently disposed of by the reflexion that while currencies can be doubled in a week, hours of labour cannot be much increased, and it takes many years to double the working population.

It follows that if the unit in a currency is to maintain its purchasing power, the issue of that currency must not be unlimited in amount. The wildest currency crank has never gone so far as to propose that every one should be allowed to print and pay out on his own account as many legal-tender inconvertible notes as he likes. When the power to create such currency has been given, it has always been entrusted to a Government or to a bank under the influence of Government, and the trustee has been expected to use discretion in the public interest so as to maintain a proper limit to the issue.

By adopting gold (or any other metal) as its standard a country abandons its power of manipulating the value or purchasing power of its currency. It surrenders the regulation of the general price-level to the forces which in the world at large determine the value or purchasing power of a particular metal. Henceforward the purchasing power of the unit of account, such as the pound or the dollar, must keep almost exactly equal to that of some fixed weight of bullion. Exactly how this equality is enforced, whether by the arrangements known as "the gold-exchange standard" or by the simpler and more "automatic" method of convertibility and free export and import of coin and bullion, is immaterial; the essential thing is that in one way or another the coins or notes which pass for units of account are, and remain, equal in value to a certain quantity of free bullion. This is equivalent to saying that the purchasing power of the national currency is regulated by that of bullion in the world at large. If the metal becomes scarce in relation to the world's demand, so that its general purchasing power rises, the currency of any country based on it must follow suit, and prices fall; and *vice versa* if the metal becomes more plentiful in relation to the demand, prices rise. Prices cannot be raised by the Government or the bank issuing more paper currency, since no more can be issued and remain out than will circulate at par with bullion; prices cannot be lowered by the Government or the bank calling in what they have issued, since the mint is open and coin will replace the paper withdrawn. The currency policy of the single nation can no longer affect the purchasing power of its money except in the trifling degree in which it can affect the purchasing power of bullion in the world, by slightly increasing or decreasing the total demand for it.

To some this surrender of national autonomy in the matter of price-level seems mere pusillanimity. Why not retain the power of regulation, and use it to secure what nearly every one professes to regard as the ideal—stability of prices?

In the first place, because the gold standard, adopted as it was before the war and as it will be again by the better part of the civilized world, provides a common international standard, with its consequence of stability of the international exchanges, while "managed" national currencies, even if each attained the ideal of internal stability which it set before itself, would not do so. It is sometimes thought that if each of a number of countries managed its own currency so as to keep it stable, all the currencies would be stable in relation to one another, so that the international exchanges would not vary appreciably. In fact, however, they would vary greatly, since different peoples living in different situations and using different commodities and services have quite different ideas of what constitutes a fall or a rise in general prices. In the language of the statistician, they put different things into the calculation of their index-number of prices and give them different weights. And even when they took the same action in the same degree there would be considerable differences in the celerity with which they would take it.

Secondly, the surrender of national autonomy in regard to price-levels by the readoption of the gold standard does not in practice mean the abandonment of a fair prospect of stable price-levels, but the restoration of a very effective barrier against gross inflation.

There is not the least reason to expect that any country—and still less that all, or most, countries—will, in fact, manage currency so as to preserve a stable price-level. In Mars or some other world which we can suppose exempt from human failings the thing would be easy. The issue of currency would be in the hands of an authority gifted with all wisdom and virtue, so that it would always be able to see when an increase of currency was necessary to prevent a fall of prices and when a decrease was necessary to prevent a rise, and always be willing to exercise its discretion without fear or favour. But in this world of ours there are difficulties not likely to be overcome for a generation at least. Experience shows that the general ten-

dency of nationally "managed" currencies is towards over-issue and consequent depreciation at various rates, mostly rapid. In the long run the temptation to issue more than is consistent with the keeping down of prices to the existing level is always too great.

If the issuing authority is Government, or much influenced by Government, there soon comes a time when, rightly or wrongly—much more often, at any rate, wrongly—it seems only patriotic to disregard the consequent rise of prices and print more money in order to make it easier for the Government to pay its way for the moment. For the moment the Government benefits, both because it has the additional currency to spend, and because the issue eases the money market and makes it easier to borrow: in the end the position of the Government will be worsened, but the day of reckoning will, it is hoped, come at a more convenient season. If, on the other hand, the issuing authority is fairly independent of Government influence in its cruder sense, it is still likely to be misled by misapprehension of what constitutes patriotism. Sooner or later it will "sacrifice financial orthodoxy" by succumbing to the propaganda of those business men who tell it that the one thing necessary to make trade hum and give more employment is to print and issue plenty of currency—or, at any rate, "just a little more, to give things the fillip they require."

Reference to an index-number of prices is not in the least likely to check the insidious beginnings of depreciation. The perfect index-number would satisfy the average man, and the average man does not actually exist: all who depart from the average would find it more or less unsatisfactory. Thus index-numbers of prices, however good and up to date they may be, will always find hostile critics prepared to show that they are wrong. Even if the general goodness of the number is admitted, it is always possible to argue that any particular change in it should be disregarded, because it is due to seasonal, temporary, or speculative influences—"in a month or two things will have righted themselves, and the currency authority should not be guided by a mere vagary of the index-number, but should look forward."

As against this, the widespread restoration of the gold standard is much more promising. When a country has once joined

the gold block, it cannot depreciate its own currency without again cutting itself loose from that block, and this cannot be done in the insidious and unnoticeable manner in which a career of inflation can be begun under a paper standard. Infinite dispute is possible over the question whether a pound will buy as much of commodities and services in general to-day as it did a month or a year ago; very little dispute is possible over the question whether it will buy 113 grains of fine gold or not. Hence the limit imposed by the gold standard upon the issue of currency is much more effective than the limit which is or would be imposed by a pious resolution to regulate the currency so as to preserve a stable general purchasing power.

It is this barrier against inflation which the civilized world is hoping to see re-established. In order to justify the hope, we need not claim that the stability of gold has been ideal in the past or will be so in the future. All that we need is to believe that gold is likely to be a great deal more stable than a multitude of nationally managed currencies. In the past, it is true, gold has varied considerably in purchasing power, but its variations have been small and slow compared with the variations of nationally managed currencies—it never varied as much in twenty years as the managed currency of the great and intelligent German nation varied in twenty days in 1923. There is little reason to expect any change in this respect. Gold may fall or rise, but the quantity in existence above ground is so large in proportion to any probable annual output and consumption that its value is not likely to move rapidly in either direction. The fact that some high authorities are afraid of a fall and others of a rise is somewhat reassuring.

There is no need to believe that the gold standard will for ever remain the best possible standard. That would show insufficient appreciation of the general lesson of history. All that we require to believe is that gold is the best standard for the immediate future, because it is for that period the only common international standard which the nations are in the least likely to accept, and because that common international standard is for that period much more likely to be stable than the nationally managed currencies which are the only alternative.

V

MORE ELEMENTARY ECONOMICS WANTED

[A letter to Sir Ernest Benn, who complained in *The Times* that the teaching of economics was inefficient.]

August 8, 1925.

DEAR SIR,—

It is perhaps a little late to be replying now to your letter of 22 Sept., 1924. I was on the Atlantic then, and when I got back there were such arrears of correspondence and other business to attend to that yours got neglected.

I don't much care about " movements " : an academic teacher usually finds himself in difficulties when he takes part in them. But I followed your correspondence about books with much interest.

Much of the trouble arises from the fact that some of us don't want to write really elementary stuff, and those that do can't do it intelligibly. Consequently there is no popular comprehension of how we actually live. Suppose you hired some pretty able economist to explain why people are employed and produce things that are wanted, it is ten to one or 99 to 1 that he wouldn't do it, but would try to explain why they don't *all* get employed, and leave the main question quite unexplored. So to the ordinary mind, bricklayers and miners, instead of being thought of as groups of persons to be increased or reduced as occasion requires by the offer of greater or less inducement to be bricklayers or miners, become unalterable bodies with a right to customary wages whatever happens. Or suppose you asked for a simple dissertation on " profits," you would get something like the metaphysicians' search blindfolded in a dark room for a black hat that wasn't there, instead of the kind of analysis which would make Mr. —— unable to say that the Government should take over the mines and work them " not for profit but for service " without realizing that he was talking nonsense.

It is the fashion to laugh at the old children's books on economics like Mrs. Marcet's *Conversations*, Wm. Ellis' *Outlines* and Mrs. Fawcett's *Political Economy for Beginners*, but they were good for their time, and nobody produces anything comparable

with them now. I don't know what you can do. It's no use asking me: I've tried twice. . . .

I suppose experience will teach in the end. I am told that even some of the miners' leaders are aware that the real explanation of their poor position is that the number of miners in the world is too large, though they haven't got as far as adding "and must be reduced," and a trip to America would convince Karl Marx himself that he was a false prophet, the proletariat there is becoming so bourgeois.

VI

MORE MOBILITY WANTED

[A letter in answer to a question.]

September 16, 1925.

DEAR SIR HUGH BELL,—

I am not quite sure what the question is, but if it is Do I agree with you? the answer is in the affirmative.

I would not say, however, that Evan Williams's proposition that wages must be regulated by the ability of the industry to pay is a truism. I think it is rather a fatuity, like the maxim Charge what the traffic will bear. When people say that, I ask But what traffic? The present traffic or a greater or less traffic? And so with an "industry," if the ability of the industry to pay is talked of, I want to know how many people it is to pay. If the number of miners in the world were doubled, the industry certainly couldn't pay sixpence an hour: if it were halved, the industry could pay more than it does now.

It would be an enormous advantage if people who talk about these things would only recognize that variations in wages are desirable just for the same reason that variations in prices are desirable. Prices should go up to encourage the production of an article and go down to discourage it: and similarly what is paid for any particular kind of labour should go up to keep people in that kind of work and entice others into it, and go down to push some out and prevent others coming in. Sliding-scales seem attractive from this point of view, but they lock the stable-door after the steed is stolen, since they operate after the event instead

of by anticipation like the market. Profit-sharing is better, as a man can take his share of profit and go, and he will anticipate a big or little profit-share: but individual-firm profit-sharing is absurd—the same work ought to be paid the same wage whether it is done for a well-managed and successful concern or an ill-managed and unsuccessful one. I think it possible that a scheme under which the wage-earners received a cash bonus in proportion to the success of the *whole* industry might work well if practicable, and told the Sankey Commission so. [See my *Coal Nationalization*, 1919, the unbowdlerized version of my evidence.]

. . . . .

The unemployment insurance and the Rent Restriction Acts are the two biggest causes of the long continuance of the war-dislocation effects, by making labour less mobile and less ready to accept necessary reductions. The absolutely fraudulent dole-taker is a red herring: the real point is the greater reluctance of the perfectly honest person to do what doesn't precisely suit him or move to some place he doesn't much want to go to, and still more, I think, the greater reluctance of the unions to agree to a drop in wages now they have each to think less about the unemployed in their own trade.

Well, well, it is no use grousing. I always think of Wicksteed looking at some rose-bushes covered with a mass of aphis, and remarking calmly, "It's wonderful how things get over their pests," and of Adam Smith's reported, "Sir, there is a great deal of ruin in a nation." Moreover, last year I went to America, and that should cure anyone of belief in red ruin and bloody revolution. The proletariat is becoming so "middle-class." I only had five nights in trains but came across two of the negro "porters" who talked to passengers about their investments. No doubt we are only a bit behind the times. What bothered me was to account for the much greater productiveness of industry there: I don't think much of it can now be due to the alleged "newness" of the country—I fancy it is due chiefly to greater mobility of mind and body and to the easygoingness and cheerful self-confidence of the American character, and I fancy I see signs here of the young generation getting more like that, instead of taking things so solemnly to heart as we have been accustomed to do.

1926

I

A REVIEW OF 1925

[In the *Manchester Guardian Commercial*: Annual Review, January 28, 1926.]

As we get older the years seem to come faster. We can all remember when it was quite an event to put a fresh number of the Christian era at the top of the first letters we wrote in January; now we change the date of the year with as little emotion as that with which we used to change from one month to the next. Even the end of the quarter-century leaves us cold; it is the third which we have seen, and yet things are going on much as they always did. We prate of rapid change, but fifty years make little difference except to the personnel. If a man who left Manchester fifty years ago were now to revisit it, he would not recognize a single person, but he would be able to find his way about the streets and the inside of most buildings without much difficulty; I dare say he might even catch the same train to Alderley Edge. As things get bigger and more elaborate they become less easy to alter. Chicago now is much more like the Chicago of fifty years ago than the Chicago of 1876 was to the Chicago of 1826. New countries get settled; I recently stayed with people not two hundred miles from Chicago who had lived in the same house for sixty years, and that without ever altering it.

On March 9 it will be one hundred and fifty years since Adam Smith published the *Wealth of Nations*. In the palmy days of the Victorian Jubilees we used to smile in superior fashion over what we conceived to be his ill-grounded pessimism when he said it was improbable that the States of Europe would remain solvent, and that it was quite Utopian to suppose Great Britain would ever adopt a completely Free Trade policy. The compulsory

composition of 6*s*. 8*d*. in the pound which France made with her creditors in 1797 was so completely forgotten that a leader of the British House of Commons during the war had never heard of it, and the last remnants of Protection had long disappeared from the British fiscal system. Now we know that our conceit was at least premature. Either by simple repudiation or by what Smith quite rightly considered the much worse method of currency depreciation, all the Great European Powers except one have defrauded their creditors of more than two-thirds of their due, and Great Britain is engaged in a piecemeal restoration of the old fiscal system, though Protection is supposed to smell more sweet when renamed "Safeguarding," as if there were some difference between guarding safely and protecting. "By means of the Finance Act and the Safeguarding Act," the Empire Industries Association proudly says, "a substantial measure of safeguarding against unfair competition has been accorded to a variety of industries, and, roughly speaking, one-fifth of the manufactured goods imported in 1924 have become liable to Customs duties as a result of the legislation of 1925."

These are depressing thoughts, and one of the great events of 1925—the coal crisis—has no tendency to dispel them. Here we have a great world-industry which, owing to the war and the semi-war which followed it, underwent a number of temporary local shrinkages which caused expansions elsewhere and at last left the whole expanded to a magnitude which was incompatible with the maintenance of prices sufficient to keep the producers in their usual place in the scale of occupations. The old policy would have been to let them fall below it for a time, until the resulting shortage of recruits to the industry caused at once a restoration of the usual conditions and a shutting down of the least productive sources of supply. Instead of adopting this plan, and endeavouring to shorten the process and alleviate in every possible way whatever individual suffering it causes, we subsidize the production of coal out of the national revenue, and set up a quartet to advise us publicly what we ought to do when we are tired of paying the subsidy. Then, when the advice of the four men, or of the two of them which, having the chairman, constitute a majority, is available, we shall, after all, have to decide whether to follow it or not. Probably it will be better not to follow it, in which case we shall only have increased our difficulties.

Nevertheless the year 1925 need not cause us to abandon the attitude of chastened optimism which has characterized these annual reviews since the war. For one thing, it has seen the long hoped for return of Great Britain and the Dominions to the old gold standard. Holland and her dependencies having returned at the same time, and only Poland having fallen away, the world-restoration of a common unit of valuation is now very nearly complete. For the moment France occupies the stage. For her the most that can be said is that no other country in the world could have done what she has done without causing a panic-stricken " flight " from the national currency, and a consequent complete collapse of its value. But even she cannot endure much longer, and we may be sure the franc will soon be a gold franc once more, though whether it will be the old one or a much smaller one no man can tell.

So far, gold shows little sign of justifying the predictions either of the school which alleged there would be far too much of it and a consequent "gold inflation," or of the opposite school which expected an acute shortage and a disastrous fall of prices. By the time it decides to go violently one way or the other humanity may be better equipped with sound theory and experience to deal with it. Meantime let us enjoy the peace from cranks and politicians which it gives us.

Discrepancies between the currencies of different nations have in most ages afforded great support to illiberal fiscal policies by facilitating the creation of mercantilist bogies. The recent period has been no exception to the rule. Great countries have been actually accused of deliberately depreciating their currencies in order to give themselves an " unfair " advantage in foreign trade. With the readoption of the common gold standard we may expect to see some weakening in Protectionist propaganda.

But the support which Protection gets from depreciated exchanges is a small matter compared with that which it derives from the possibility of war and all the hatred and suspicion which that possibility engenders. Most of the stock arguments for Protection are at bottom " national security " arguments. It is alleged to encourage the growth of population, and the chief recommendation of large population is that victory in war goes to the big battalions. It is intended to provide self-sufficiency, and

the chief recommendation of self-sufficiency is that the self-sufficient country can stand a blockade.

Now whatever views we may hold about the precise machinery of protocols and pacts which have been proposed, rejected, and accepted for the prevention of future wars, scarcely any of us will be inclined to disagree with the proposition that the year which has just passed marks a great advance in the growth of a peaceable international spirit. We can imagine the almost forgotten ex-Kaiser rubbing his eyes on opening his newspaper to see pictures of the friendly reception of the German delegates in Whitehall, and to read of the enthusiastic applause meted out to the smallest exhibition of merit displayed by a German football team at Oxford. And we can suppose his unmailed fist must have fallen somewhat heavily on the table when Hindenburg—*President* Hindenburg!—broadcasted pacific messages of goodwill from Germany to all nations. *Et tu!* Even the two divisions of Ireland have hastily tucked up their proverbial coat-tails out of harm's way.

At the moment there are a good many more nations with separate military forces and separate fiscal systems than there were twenty-five years ago, when Sweden and Norway were still united. The first quarter of the century has been an era of disruption: but in the next or the next but one an improved and more common-sense international spirit will probably bring about a much greater unification than that which existed in 1900. After all, though great empires founded on conquest have always, and usually soon, fallen in pieces, unification has made pretty steady progress throughout the history of the world. We think of old Rome as master of the world because we know nothing of the thousands of separate nations outside her empire. In fact, her empire at its biggest was about half the size of Brazil and must have made but a small increase of the average size of the national territories of that time. Blood, it is said, is thicker than water, but in the long run propinquity has always beaten blood, and the propinquity of men to one another has enormously increased when measured by anything except mere mileage. Measured by ease of transport and communication, Europe outside Russia is far smaller than Great Britain or even Switzerland was two hundred years ago.

It is quite impossible to believe that the present barriers against

the free movement of persons and goods will be long maintained by the two dozen States between which Western Europe is now divided. A perception of common interest must soon lead to Customs unions being concluded here and there, and when the movement is once begun it will be difficult to stop, as the largest combination will offer great attractions to other units. The Americans, by insisting that Europe must pay her debts, are helping to foster the feeling of common interest. Few things could be better devised to cultivate that feeling than the necessity of paying annually large sums to a distant nation as the price of her intervention in a purely domestic quarrel; especially when that nation unified separate territories and abolished tariffs between them a century and a half ago, and depends for all her greatness and prosperity on that fact.

Hence we should not dismiss as altogether Utopian the talk of a European, or at all events a Western European, Continental Customs Union or Zollverein, which was heard last year in the most unlikely quarters. Sooner or later, unless the whole system of Customs duties is first abandoned, such a consummation will come about. Great Britain will then have the choice of joining the Continent or becoming a perfectly free port. It is scarcely conceivable that she could stand outside with a protective system of her own.

Lastly, even in regard to our Old Man of the Sea—unemployment—the year 1925, apart from coal, has been a little more promising than its immediate predecessors. It justifies Adam Smith's cynical remark that the body politic, like the natural body, often recovers, not only in spite of the disease, but in spite also of the absurd prescriptions of the physician. A most favourable symptom is observed in the gradual disappearance of the demand that the Government ought to do something to provide employment. The basis of free labour is that the worker selects his own work by offering what other people happen to be willing to pay for. When the community resolutely refuses to pay for new ships which it does not want, the number of shipwrights gets cut down in time by the cessation of the flow of recruits to the industry, even if every existing shipwright is maintained unemployed by an unemployment fund to the day of his death; and the most elaborate arrangements of the employed in trades from which more product is wanted has never so far

been very successful in preventing their expansion. Expectation of Government assistance only hinders the mobility of existing workers, and the fact that nobody now expects the Government to do anything more is all to the good.

"Heaven helps those who help themselves" is a good maxim, and we need not apply it only to the wage-earners. Economic pressure stimulates the profit-maker also to beneficent exertion. Shrewd old John Kennedy is said to have observed that no improvement in manufacture was made except on threadbare profits,[1] and I have myself heard a millionaire admit that "the business used to run of itself, and I could take three or four days off in the week for things I liked to do, but now I have to work quite hard for my living." The severe pressure that has been put on all management by the difficulty of reducing wages as much as prices have fallen has a very good side. It has forced thought and energy into the task of economizing labour and material in such a way as to make the worker really produce more, so that he may be really worth the higher real wage which he gets.

II

ADAM SMITH AS ECONOMIST: THE GOSPEL OF MUTUAL SERVICE

[From *Economica* for June, 1926. The first of a series of seven lectures on Adam Smith delivered by various lecturers at the London School of Economics in Lent Term, 1926, to commemorate the completion of a hundred and fifty years since the publication of the *Wealth of Nations*.]

I HAVE no responsibility for this choice of subject. I would not have chosen it myself, because I was acutely conscious of the difficulty of saying, one hundred and fifty years after the publication of the *Wealth of Nations*, anything which is both new and true about it. I do not profess to have solved the difficulty now. I hope what I shall say is true; but as for newness, I can only be

[1] This "axiom" of the "father of the cotton manufacture" is quoted by F. A. Walker in *The Wages Question*, 1876, p. 257. In Kennedy's own *Miscellaneous Papers*, 1849, "Memoir of Samuel Crompton," p. 66, it appears in a less picturesque version, in conjunction with a denunciation of "fear of over production" and "obstinate resistance to a reduction of prices."

like the candidates for Ph.D. degrees, who when their supervisor says, "I can't see that you are discovering any new facts," plead "But don't you think I might be held to have 'exercised independent critical power'?"[1]

Very little of Adam Smith's scheme of economics has been left standing by subsequent inquirers. No one now holds his theory of value, his account of capital is seen to be hopelessly confused, and his theory of distribution is explained as an ill-assorted union between his own theory of prices and the physiocrats' fanciful Economic Table. His classification of incomes is found to involve a misguided attempt to alter the ordinary useful and well-recognized meaning of words, and a mixing up of classification according to source with classification according to method or manner of receipt. His opinions about taxation and its incidence are extremely crude, and his history is based on insufficient information and disfigured by bias.

But three great things he did accomplish.

The first was the definite substitution of income—"produce" as he called it—for the older idea of a capital aggregation of "treasure" or something akin to "treasure." He was quite aware of what he was doing here. The Introduction and Plan which he prefixed to the *Wealth of Nations* begins with two paragraphs in which the continuous attainment of a large quantity of the necessaries and conveniences of life is treated as the end of economic endeavour, and it ends with a sentence in which the "real wealth" of a nation is taken to be "the annual produce of the land and labour of the society."

Of course this idea was not new in the sense of springing from Adam Smith's head like Athene from that of Zeus. The seed for it had been sown by the calculations of the English political arithmeticians in the end of the seventeenth century, and its germination had been assisted by the physiocrats' discussion of what they called "the annual reproduction" and its "distribution." But Smith must be given the credit of getting in the harvest.

Right down to his time the reigning school of economic thought was open to the reproach which he levels against it when he says that it represented the great object of the industry and commerce of a nation to be the multiplication of gold and silver within it.

[1] London University Ph.D. Regulations, section 5 *b*.

It is no use to pretend that this was confined to the small fry of less reputable writers. With the possible exception of Sir William Petty, Cantillon was the acutest economist of the period before Adam Smith, and in some directions anticipated doctrine which did not come into fashion till a century and a half after his own time ; but what does he say ? At the beginning of his *Essai* he says " *la richesse en elle-même n'est autre chose que la nourriture, les commodités et les agréments de la vie,*" and he heads chapter xvi of Part I " *plus il y a de travail dans un Etat, et plus l'Etat est censé riche naturellement.*" This raises great hopes, but they are rudely shattered by what follows. Calculating that only 25 per cent. of the population can be regarded as available for any labour other than that required for the production of the absolute necessaries of life, Cantillon says that if some of these persons are employed in beautifying the people's apparel and refining their food, their country " will be considered rich according to the amount of this labour, though it adds nothing to the quantity of things necessary for the subsistence and maintenance of men." But, he thinks, if the same persons are employed in getting metals out of the earth and fashioning them into tools and plate, the country will not only appear richer but " will really be so."

> " It will be so especially," he proceeds, " if these persons are employed in drawing from the bosom of the earth gold and silver, metals which are not only durable, but so to speak permanent, which cannot be consumed even by fire, which are generally received as the measure of value, and which can at all times be exchanged for everything necessary for life : and if these persons work so as to bring gold and silver into the country in exchange for manufactures and wares which they have made there, and which are exported to foreign countries, their labour will be equally useful and will really benefit the country.
>
> " For the point which really seems to determine the comparative grandeur of States is the body of reserve which they have over and above the annual consumption, like stores of cloth, linen, corn, etc., to serve for lean years in case of need or in case of war. And inasmuch as gold and silver can always buy all these things even from the enemies of the State, the true body of reserve for a State is gold and silver, of which the greater or less actual quantity necessarily determines the comparative grandeur of Kingdoms and States." [1]

Sir James Steuart brought out his book—the first in English with the title of *Political Economy*—in 1767, and its 1,300 quarto

[1] *Essai*, pp. 117-19.

pages quite fail to make clear what he thought constituted the wealth of society. Even the great Turgot, though he is sound enough about money and bullion, does not adopt the idea of produce or income being the wealth of society, but says the riches of a country are to be found by multiplying the annual value of land by the number of years' purchase and adding the value of moveable goods.[1]

The statesmen or politicians were, as usual, worse than the economists. Necker, in 1776, the year which we are now commemorating, included in the riches of the State "neither the land which supports the people nor the advances in tools, in animals, in buildings, in things necessary for sowing and cultivation;" because "all this is absolutely a part of the population since it is impossible to separate man from his subsistence."

> "So," he continued, "the only riches which form a power distinct from the population are the surplus of goods of all kinds which are gradually amassed in a society, and which, being susceptible of exchange against the services of foreigners, can increase the public power.
>
> "These goods consist to-day chiefly in treasures (*matières précieuses*) such as gold and silver; because these metals have become the common measure of exchanges, and the sure means of acquiring everywhere all the productions of the land and the labour of men."[2]

To change all this, to recognize that not a hoard of gold and silver, nor even a store of all kinds of valuable and useful things, is the end of economic endeavour, but instead a large continuous produce or supply of consumable necessaries and conveniences—that, in short, as Smith himself put it,[3] "Consumption is the sole end and purpose of all production," was a great service. It marks the transition from the state of mind of the savage who can only think of what he has in hand, to the state of the civilized man who looks before, and considers himself well off when he is assured of having adequate supplies of food and other necessaries and conveniences in the future.

The second great change which Adam Smith made in general theory was to substitute wealth per head for wealth in the aggregate, whatever that may be. He does this in the second

[1] *Réflexions*, xci.

[2] *Sur la législation et le commerce des grains*, chap. iv.

[3] *Wealth of Nations*, Vol. II, p. 159.

sentence of the *Wealth of Nations* in his stride, so to speak, apparently without noticing that anything important was happening: " The nation," he says, " will be better or worse supplied with all the necessaries and conveniencies for which it has occasion " according as the produce " bears a greater or smaller proportion to the number of those who are to consume it." That is, he will consider the nation wealthy or not wealthy according as its average worker is wealthy or not wealthy, and not according as the sum of all its members' wealth is great or small.

By this he threw over the old idea of an entity called the state or the nation existing outside the individuals who constitute its subjects or members, and flourishing or languishing irrespective of their prosperity. To us that may seem a small thing. We are accustomed to think of Switzerland or of Denmark as a rich nation compared with Russia. But it was a great break with tradition in 1776, so great that Smith himself often fails to live up to it, and drops back into speaking of China as rich, while at the same moment insisting on the extreme poverty of the Chinese. Cantillon had had a glimmering of it in 1730, when he wondered whether it might not be better to have a smaller well-to-do population than a larger poor one, but he dismissed consideration of the matter as outside his subject.

It was a change in accordance with the humaner spirit of the age. The " nation " was henceforth to be the whole people and not merely the King or the ruling classes, who, being themselves above the reach of want, could afford to pursue national glory and power and despise the sordid considerations which invade the homes of the people. No longer were the people to be regarded as mere pawns to be used as required in the queer game of accumulating a hoard of treasure of which the only conceivable use was to be sent abroad again in time of war. They were to be a body of persons whose individual necessaries and conveniences of life were to be the objects to be pursued. " Political Economy," Smith says himself in the Introduction to Book IV, had to teach the Statesman how to get revenue for the State, but also, and firstly, to " provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves."

There are difficulties, of course, about accepting the average

wealth as conclusive. Those which concern the validity of the average (whatever average is taken) as a measure of general individual wealth we may dismiss as matters of detail, but it is otherwise with the difficulty which confronts us when we are asked whether indefinite diminution of numbers, provided it is accompanied by increasing wealth, is good from an economic point of view. Smith himself evaded this difficulty by his firm belief that prosperity and population move together, but we know that they often do not. Yet at any rate Smith's view was better than the one which it displaced. Within certain limits, at any rate, we may be satisfied to prefer the high average to the high aggregate.

The substitution of the average for the aggregate involved that approval of high wages which marks off the economists from the more ill-disposed employers whom the socialists persist in supposing them to represent. Nowadays even, there are some persons who will tell you that low wages are a great "advantage" to Japan and Germany. In Smith's day they were probably more predominant. With them he reasons gently but persuasively: "What improves the circumstances of the greater part can never be regarded as an inconveniency to the whole. No society can surely be flourishing and happy of which the far greater part of the members are poor and miserable" (vol. i, p. 80). Wage-earners are the most numerous income-receiving class, so that an increase of wealth per head is not likely to take place without an increase of wages.

Smith's sympathies, indeed, seem to have been wholly with the industrious wage-earner, and especially with the poorest. In the *Lectures* we find him telling his Glasgow students:—

> "The division of opulence is not according to the work. The opulence of the merchant is greater than that of all his clerks, though he works less; and they again have six times more than an equal number of artisans. . . . The artisan who works within doors has far more than the poor labourer who trudges up and down without intermission. Thus he who as it were bears the burden of society has the fewest advantages." [1]

The employers of his time and their spokesmen were always complaining that high wages ruined their workmen by making them drunken and disinclined to work more than half the week.

[1] *Lectures*, p. 163.

In his *Lectures* Smith speaks as if he accepted the fact so far at least as the "commercial parts of England" and especially Birmingham were concerned, summing up the result in a Ruskinian phrase, "So it may very justly be said that the people who clothe the whole world are in rags themselves."[1] He does not, however, suggest reduction of wages as a remedy, but elementary education and a consequent abolition of early employment of children. In the *Wealth of Nations* he pooh-poohs the whole theory of high wages ruining workmen. Industry, he thinks, is improved by encouragement:

> "A plentiful subsistence increases the bodily strength of the labourer, and the comfortable hope of bettering his condition, and of ending his days perhaps in ease and plenty, animates him to exert that strength to the utmost. Where wages are high, accordingly, we shall always find the workmen more active, diligent, and expeditious than where they are low; in England, for example, than in Scotland."[2]

It is said, he observes, that "in cheap years workmen are generally more idle and in dear ones more industrious than ordinary," but this, he believes, is merely the result of masters being able to make better bargains with their men in dear years, which they then naturally commend as more favourable to industry.

"Some workmen, indeed," he admits, "when they can earn in four days what will maintain them through the week, will be idle the other three. This, however, is by no means the case with the greater part." The majority, he thinks, are more likely to overwork themselves when paid liberally by the piece; "excessive application during four days of the week is frequently the real cause of the idleness of the other three, so much and so loudly complained of."[3] "If masters would always listen to the dictates of reason and humanity they would have frequently occasion rather to moderate than to animate the application of many of their workmen."

Smith thus started the line of thought which was continued by what are called the classical economists. A recent writer has actually said that those economists "defended subsistence wages." Of all the libels upon them invented by socialist and

[1] *Lectures*, p. 257. [2] *Wealth of Nations*, Vol. I, p. 83.
[3] *Ibid.*, Vol. I, pp. 83, 84.

semi-socialist writers this is about the worst. They may have been, they certainly frequently were, wrong about the causes of high wages, but they were always in favour of them. Malthus devoted years to his propaganda for raising wages by reducing the supply of labour. Ricardo certainly reckoned himself among those "friends of humanity," who, he says, should wish the labourer to have expensive tastes so as to keep the supply of labour down and wages up. McCulloch, who is so often a very present source of comfort to the enemies of the classical economists, is never tired of insisting on the advantage of high wages, as a glance at the heading of Wages in the index of his *Principles* will show.

Thirdly, Adam Smith may fairly claim to be the father, not of economics generally—that would be absurd, but of what in modern times has been called, with opprobrious intention, "bourgeois economics," that is, the economics of those economists who look with favour on working and trading and investing for personal gain. We are apt to forget that the idea that a wage-earner, a trader, or an investor may be, and indeed generally is, a very respectable person is very modern. From Homer we learn that the people whom Odysseus visited on his travels thought it all the same whether he was a trader or a piratical murderous marauder. Primitive people are said to have regarded exchange as a kind of robbery rather than as a mutual giving. Greek philosophers thought wage-earners incapable of virtue, and money-lenders have been objects of antipathy throughout the ages. In Smith's own time Dr. Johnson and Postlethwayt very seriously considered whether a trader could be a gentleman.

Smith came forward as the admirer and champion of the man who wants to get on. Probably, like many another Scotch boy, he had learnt that gospel on his mother's knee. He did not get it from his master, Hutcheson, for he complained that Hutcheson did not sufficiently explain "from whence arises our approbation of the inferior virtues of prudence, circumspection, temperance, constancy, firmness." Regard, he said, for "our own private happiness and interest" is often a laudable principle of action.

"The habits of economy, industry, discretion, attention and application of thought are generally supposed to be cultivated from self-interested motives, and at the same time are apprehended to be very praiseworthy qualities which deserve the esteem and

approbation of everybody. . . . Carelessness and want of economy are universally disapproved of, not, however, as proceeding from a want of benevolence, but from a want of the proper attention to the objects of self-interest."[1]

Far from making people inclined to cheat, he held, commerce made them honest and desirous of fulfilling their contracts. He told his Glasgow students, according to the report of one of them :

"Whenever commerce is introduced into any country, probity and punctuality always accompany it. These virtues in a rude and barbarous country are almost unknown. Of all the nations in Europe, the Dutch, the most commercial, are the most faithful to their word. The English are more so than the Scotch, but much inferior to the Dutch, and in the remote parts of this country they are far less so than in the commercial parts of it. This is not at all to be imputed to national character, as some pretend ; there is no natural reason why an Englishman or a Scotchman should not be as punctual in performing agreements as a Dutchman. It is far more reducible to self-interest, that general principle which regulates the actions of every man, and which leads men to act in a certain manner from views of advantage, and is as deeply implanted in an Englishman as a Dutchman. A dealer is afraid of losing his character, and is scrupulous in observing every engagement. When a person makes perhaps twenty contracts in a day, he cannot gain so much by endeavouring to impose on his neighbours as the very appearance of a cheat would make him lose. When people seldom deal with one another we find that they are somewhat disposed to cheat, because they can gain more by a smart trick than they can lose by the injury which it does their character.

"They whom we call politicians are not the most remarkable people in the world for probity and punctuality. Ambassadors from different nations are still less so. . . . The reason of this is that nations treat with one another not above twice or thrice in a century, and they may gain more by one piece of fraud than lose by having a bad character. . . . But if states were obliged to treat once or twice a day, as merchants do, it would be necessary to be more precise . . . a prudent dealer, who is sensible of his real interest, would rather choose to lose what he has a right to, than give any ground for suspicion."[2]

In the *Wealth of Nations* Smith says, like a true bourgeois : "Bankruptcy is perhaps the greatest and most humiliating calamity which can befall an innocent man." Throughout the book he treats prodigality with bourgeois contempt ; it is a kind of mental aberration : sane men save :

[1] *Moral Sentiments*, pp. 464–6. [2] *Lectures*, pp. 253–5.

"With regard to profusion, the principle which prompts to expense is the passion for present emjoyment; which though sometimes violent and very difficult to be restrained, is in general only momentary and occasional. But the principle which prompts to save is the desire of bettering our condition, a desire which, though generally calm and dispassionate, comes with us from the womb and never leaves us till we go into the grave. In the whole interval which separates those two moments, there is scarce perhaps a single instant in which any man is so completely satisfied with his situation as to be without any wish of alteration or improvement of any kind. An augmentation of fortune is the means by which the greater part of men propose and wish to better their condition. It is the means the most vulgar and the most obvious; and the most likely way of augmenting their fortune is to save and accumulate some part of what they acquire, either regularly and annually or upon some extraordinary occasions."[1]

All this approval of the man who wants to get on in life, succeed in business, or whatever you like to call it, would have been a very poor gospel if such success were only purchased at the cost of depressing other people. But in Adam Smith's view it was not. On the contrary, he held that commerce and investment having been introduced, each man by trying to help himself, in fact, not only helped himself, but all others.

So, in his opinion, when "the butcher, the brewer, and the baker" provide us with our dinner, not because they love us, but because they wish to benefit themselves, they need not be ashamed of the fact. Let them go on doing their best to serve their own interest, and they will serve us and society generally better than "if they affect to trade for the public good," and better than if the State tries to regulate their prices.

He pictured the vast multitude of persons in various parts of the world co-operating in the production of the modest coat of the labourer; he showed how their specializing in their respective occupations increased their product; he described this division of labour as the greatest cause of the superior opulence of civilized mankind over their primitive ancestors and their uncivilized contemporaries. And he pointed out that the co-operation was not due to any effort of collective wisdom, but to men's natural propensity to serve their own interest by "truck, barter, and exchange of one thing for another." He described the increase

[1] *Wealth of Nations*, Vol. I, pp. 323–4.

of capital as another great cause of prosperity, and said very truly that it was not the result of Government foresight, for Governments were generally prodigal and profuse, but of the frugality and good conduct of individuals desirous of bettering their own condition.

It is easy to object to the confidence in " Nature " which he displays, in accordance with the fashion of the time, when he assumes that the coincidence between self-interest and the general good establishes itself " naturally," in the absence, that is, of all human institutions except a few which were regarded as being themselves natural. In our day, with the law of property just put into an Act of several hundred pages in length, and the relations between husband and wife and between parents and children in a state of flux, we are not likely to believe in an orderly and harmonious state of " natural liberty " in which society does not presume to " interfere " with individual action. We see that self-interest, which might lead many of us to snatch jewellery from shop windows in the Strand, is made to flow in quite unnatural directions by the existence of those very artificial institutions, the Metropolitan Police and the Bow Street Police Court and Dartmoor Prison. Throughout history society has been fashioning and modifying its institutions so as to make it the interest of its members to do the right thing.

It is just the incompleteness of those institutions which have been the great obstacle to the acceptance of Smith's view in the realm of international trade. International trade is still looked on with quite primitive suspicion: each country imagines that it must be very careful not to allow its subjects to buy and sell across the national boundary as freely as they do inside it. There is no confidence that the fact that they find it profitable indicates that the country as a whole will benefit by it.

Adam Smith could see no sense in a country's refusing to let its inhabitants buy from abroad what they could buy cheaper than at home. No prudent head of a household, he said, has anything made at home when he can buy it at less expense outside, and what is prudence on the part of the householder can scarcely be folly on the part of a nation.[1] Why, then, this persistence of fear of cheap imported goods, rising almost to panic when the price falls to zero, as when a defeated enemy consents to pay repara-

[1] *Wealth of Nations*, Vol. I. p. 422.

tions and it is realized that the reparations will be paid not in paper money or gold but in goods?

The simplest explanation that may be proposed is that nations, trying to think collectively, are stupider than ordinary householders thinking individually, so that they do by mere stupidity what the householder will not do. But there is probably more in it than that, and I am inclined to think that the true explanation is to be looked for in the very fact which Smith ignored, namely, that such harmony as is found between the pursuit of self-interest and the general good is dependent on the existence of suitable human institutions.

As between country and country "natural liberty" in the completest sense still very largely prevails. Any sovereign State may declare war upon another except in so far as it is hindered by some very recent arrangements, the strength of which has yet to be tested. Hence a prudent nation has some excuse for considering whether the immediate advantage to itself of a particular branch of foreign trade may not be outweighed by the greater strength which that trade may cause the other country to possess in some future conflict of arms. The nation, in fact, in contemplating its foreign trade, is always asking, "What if there is war?"

The existence of protection in British overseas dominions and even in the Irish Free State may be brought up against this suggestion that want of institutions giving security against foreign attack is the chief root of the general refusal to regard international trade as favourably as internal domestic trade. The Dominions, it may be said, protect themselves against the metropolitan country and each other as well as against foreign countries, and it cannot be that they suppose that there is danger to be apprehended from either. But it is doubtful if there is much strength in the objection. Tradition has enormous force in these matters. The Dominion which feels itself a separate entity is likely to behave from mere force of imitation in the way which the nations which have complete independence and sovereignty ordinarily do.

Adam Smith himself never really faced the difficulty. He was too much in the thrall of old ways of thinking which have come down from the ancient very partial civilization when the barbarians were regarded as just as much outside society as the wolves

and other wild beasts. His followers have scarcely improved on him to this day, and still get themselves into inextricable difficulties by at one moment treating "the nation" as if it were synonymous with human society, and at another recognizing that it is only a section which may be doing its level best to harry, kill, and erase the memory of some other section or sections.

But though Smith was wrong in supposing that the desire for individual gain would pull the industrial chariot safely along in the absence of harness, and though this error vitiated his doctrine and accounts for its ill-success in the international sphere, so far as internal trade and specialization of persons and places to particular occupations were concerned, he was on firm ground, because the institutions which are required for making self-interest take the beneficent road were actually there—not, of course, in a perfect form—they never will be that, but sufficiently developed to justify his view. When he describes the co-operation necessary for making the labourer's rough coat and contrasts the situation of the humblest member of a civilized and thriving nation very favourably with that of many an African king, the absolute master of the lives and liberties of ten thousand naked savages, he was in fact taking things as they were in his time. That he failed to see that self-interest had been put in the shafts and harnessed by law and order, products of collective wisdom, detracts little from the value of his exposition that it was a very good horse.

By that exposition he elevated the conception of gainful occupation and investment from a system of beggar-my-neighbour to one of mutual service. The new conception has steadily gained ground in the more advanced countries of the world. It is true that there is a numerous sect which tries to convince the wage-earners that they are working not for the public and not for the consumers of the things or the services which they produce, but for the capitalist employer who gets what is left after wages and other expenses have been met; but their sour propaganda loses force as the old theory of the iron law of wages drops into oblivion in face of obvious facts, and the nature and necessity of interest becomes more clear.

So we do not now think of work being done as by a slave for a master, and of business being engaged in as by a gambler to win gain at the expense of other players. We work for our wages and

our salaries, and even for those residues which are called profits: we save and invest for our interest and our dividends: knowing full well that the more successful we are, the better not only for ourselves but for the consumers of our products.

I hope that no teacher in the School will ever give any countenance to the pernicious belief that steady and honest service in satisfying the demand of the people for the necessaries and conveniences of life is something to be ashamed of because it is profitable. The modern workman and the modern trader can practise virtue as well as a Greek philosopher, a mediaeval begging friar, or a twentieth-century social reformer.

INDEX

Abraham, some grudge him the ram, 68
Adams, Prof. W. G. S., 341
Adscripti tabernario, 106
Agricultural Tribunal, Report of, 341–7
Agriculture, the "decay" of, great sign of progress, 123; meaning of prosperity of, 341; part of, in national life, 344
Alcohol, tax on, exception to general rule that taxes are a nuisance, 278
Alliance, the, should be permanent, 86–7, 90
Anarchy, international, 65–79
Andréades, Prof., 320
Angell, Norman, 69, 321
Annuities, long-term, from one nation to another, deprecated, 176–7, 323
Anticipation important in determination of the value of money, 386, 388
Archer, William, 169
Aristotle, 31, 285
Ashley, Prof. William J., 341
Assignats, 204
Average wealth, Adam Smith and, 420–2

Babies, economised during the war, 183
Baker, fury of London populace against a German, who baked for them, 127
"Balance your budget," 253, 374–5
Balance of trade, 246–7, 351–2, 401–2
Bank deposits, nature of, 224–6, 256–66, 295, 305
Bankers and banks, not to blame for the inflation, 224–6; cannot compel issue of Currency Notes, 230, 380–1; business of, 256–7; lending power of, limited, 259; forced to right discount policy by convertibility, 327; Keynes' high opinion of, 357; think of the institution rather than the shareholders, 373–4; economise currency, 388
Bank notes, why none under £5, 109–10; can be issued otherwise than by way of loan, 296
Bank of England, letter to, 199–200; conduct of in 1797–1821, 283–5; and rate of interest, 297–8; "safety of its establishment," 327–8, 332–3; inconvertible notes of, 373; keeps no Currency Notes, 376–7. *See* Reserve and Currency Notes
Bank of France, 393–4
Bank Rate, the function of, 190, 193–4, 200, 208–10, 293–8, 366
Bankruptcy, national, better than debasement, 252–3, 340; avoided by debasement, 328, 334; private, "most humiliating calamity," 425
Bastable, Prof. C. F., letter to, 42–4
Beer, "a sacred national institution," 135
Beetroot, infant industry of, 346

Bell, Sir Hugh, letter to, 410–11
Benn, Sir Ernest, letter to, 409–10
Birmingham, Bishop of, on regeneration by war, 165
Births in war-time, 79–83
Bonar, James, 335, 398
Bondholders, 154–5, 283, 310
Boom, 10, 97–8, 108, 315–20, 354–5
Borrowing by governments, from banks, when pernicious, 362–3; proceeds of, may redeem currency, 367
Bourgeois economics, 424
Bowley, Prof. A. L., 178–84
Bradburies, "Give us our daily," 230. *See* Currency Notes
Bradbury, Sir John, 197
Brassey, Thos., 4
Bread rations, stint the poor, 112
"Breakdown," the, of "capitalism," 31–2, 167, 184–6
Briand, 351
Brougham, Lord, 154
Bruins, Prof., 320
Budget. *See* Balance
Bullion Report of 1810, 199–201
"Business as usual," 11–14
Butter superseded by margarine, 166–8

Ca' canny, 48–9
Cambridge School, 311, 315
Cannan, Prof. E., 35, 276, 280, 284, 334
Cantillon, Richard, 259, 419
Capital, not "realisable," 44–6; large aggregate desired for war, 72; "living on," 184; not "waiting," 313–14
Carver, Prof. T. N., 276
Cassel, Prof. G., 226–9, 299–303, 320, 323–31, 355
Chamberlain, Austen, 225–6, 381, 393
Chamberlain, Joseph, 87
Chancellor of the Exchequer, prosecution of, demanded, for profiteering, 195–7
Chapman, Prof. Sydney J., 164–6
Cheques, stamp on, keeps up value of currency, 369–70; economise currency, 396
Chervonetz, 348
Child, Sir Josiah, 287–8
Christian Social Union, 14
Churchill, Winston, 403
Civil war less destructive than national, 28
Clapham, J. H., 299, 303–5
Clark, J. B., 36, 38
Clegg, W. H., 249
Clémentel, 396
Cloakrooms and banks, 256–66
Clynes, J. R., 165
Coal Commissions, 341, 411, 413
Coal control, 29–35
Coal rations, stint the rich, 150
Cobbett, 77–8
Coin, foreign, not to be melted, 212, 235 n.
Commerce introduces "probity," 425
Commercial policy and war, 120–33
Conscription, military and industrial, 135–6
Consumption and investment, 379
Continental Currency, 299
Contracts not always enforced, 172
Convertibility, true and false, 109, 114
Corn, minimum price and subsidy for, 42–4
"Cost," 311–13
Cost of living and wages, 166, 250
Cost-of-production theory of value, 94–5, 103
Couéism in economics, 316
Credit, control of, 208, 374
Crooks, Will, 91, 116
Cunliffe Committee, 186; limit, 202, 211, 354–5, 371, 377, 383, 393
Currency, inflated to support Government expenditure, 119–20; on the eve of the Cunliffe limitation, 186–95; how additional comes on the market, 205; per head, 199,

360; pre-war, 212–13; seasonal demands for, 217, 377; prices do not correspond closely, 218–20; foreign, valued for what it will buy, 245; no exception to rule of value, 245; an international problem, 299; how additions raise prices, 324, 404; sound, worth paying for, 350; situation of, Feb., 1924, 363–9; limitation of, 370–84; must be limited, 404–5. *See* Cunliffe, and Currency Notes
Currency Notes, "forced"? 115; "hot or cold," 119–20, 162; should be limited, 186–8; Bank of England should keep reserve of, 188–90, 193–4; intended by the Act to be lent, 189–90, 192; should be bought in, 203; a Government issue, 226, 285; compared with the Reichsbank issue, 353–4, 363–5; not automatically issued, 352–3, 357; reduced in 1921–3, 366, 392–3; the Account, a bank of issue, 375–84
Customs Union, possible European, 416
Cycles of trade, 315–20

D'Abernon, Lord, letter to, 192–3; 201, 255
Dalton, Hugh, 253
Davenant, Chas., 23
Davenport, H. J., 311
Daylight saving, 35
Dear, why things are, 197–9
Deaths in war-time, 79–83
Debtor *v.* Creditor, 164–6
Debts, national, 74, 78, 131, 157, 168–77, 310–11, 337–40
Deflation, disagreeable to some, 218; making progress, 280–2; of 1815–21 compared with 1920–3, 283–5; in France, 392–7
Depression, the post-war, 298, 316–19; the penalty of boom, 330
Devaluation, 360, 369
Devonport, Lord, food controller, 148, 151
Dickinson, G. Lowes, letter to, 26–8
Diminishing returns, 342
Discontent, causes of, 133–52
Discount policy, 227, 323–34
Distribution according to need, 22, 35, 149; according to service, 35, 37; improvement of, 37–8
Doctors' services included in national income, 269
Dogger Bank incident, 87
Dominions, why protectionise, 132–3, 428
Dora (Defence of the Realm Act), 370
Drago doctrine, 170
Drapery, the only purchasable thing, 159
Drudgery, good effect of some, 14

Economists, not cosmopolitan, 66–7
Economy in taxation, 277
Edgeworth, 276, 335
Einaudi, Prof., 320
Elasticity of demand, 121
Ellis, William, 257, 409
Empire, free trade within the, 70, 88
Employed, why most people are, 409
Ententes and alliances, 85
Equal distribution of necessaries bad, 149–50
Equity in taxation, 277, 279
Evans, Samuel, letter to, 229–31, 242
Excess profits tax, 62–4, 142
Expenditure not to be hurried up, 15–16
Exports always popular, 352

Family allowances, 144
Fashoda, 87
Fawcett, Mrs. M. G., 257, 409
Fisher, Prof. Irving, 40, 311, 312, 355, 358
Flag, trade following the, 27
Flappers, 133, 158

Flippers, 133
Fraser, 290
Free trade and war, 88
Furniss, H. S., 166–7

Gentlemen of England and others lived at home at ease in 1793–1815, 152
George, Lloyd, 179, 351
Gibb, Sir George, 16
Gide, Prof. Ch., 320
Gold, thrown on the market because not a munition of war, 198, 213; to collect as "backing" for an inconvertible paper currency, silly, 202, 216, 227; how new gets into circulation, 206–7, 213; exportation of, prohibited, 217, 227, 235, 237, 247; return to, easy, 226–9; demand for, not much increased by its being merely the standard, 228, 234; surrendered by the other English banks to the Bank of England, 230; effect of depreciation on gold-mining, 232; half-price, 233; currency of, not likely to be restored in England, 234, 308; for currency or only for standard, 307–9; the future of, 355–8, 391, 408; why originally adopted by England, 400–1; restored in England, 403–8; an international money, 406; limits currency, 407–8
Gold-and-silver economics superseded by Adam Smith, 418–20
Gold-inflation, 222–3, 282, 414
Gresham's law, 206, 348–50, 391
Grousing, 298, 411
Guernsey Market House, 210–12
Guillebaud, C. W., 299, 303–5

Happy home, the war has made many a, 178–84
Hargreaves, E. L., 299
Hawtrey, R. G., 205–8, 299–300
Henderson, H. D., 311–15
Herriot, 395–6
Herschell Indian Currency Commission, 398
Hilton, John, 166–8
Hindenburg, President, 415
Hirst, F. W., 49–53
History repeats itself, 152–5
Hoarders, 386
Hobson, J. A., 14, 88–90, 162–4
Honesty the best policy, 113
Horner, Francis, 326
Housing, 5–11; without paying, 210–12
Hutcheson, Prof. Francis, 424
Hutchins, B. L., 184–6

Idleness less common in modern civilisation, 252; whether encouraged by high wages, 423–4
Idlers and wastrels, unprosperous, 41
Income, the national, 11–12, 179, 268–9, 418
Income tax on savings, 274–5
Increment duty, 273
Index numbers of prices, 230–1
Industrial unrest, 133–52
Industries, decline of some, desirable, 124
Inflation, 107–20, 143–4; meaning of, 221–3; the "little," 356–7, 363
Institutions, international, necessary, 67
Inter arma silent leges, 49
Interest, reluctance to pay high, the root of debasement of currencies, 281; determination of, 285–98
International anarchy, 65–79
International trade, why suspect, 427–9
Invention, effect of, on interest, 291–2
Investment, diminished by Government borrowings, 97; of foreign capital, how affected by depreciation of currency, 244; involves spending money, 379
"Invisible" exports and imports, 247

Jacob's family, 231
Jaffé, Prof., 51, 76, 77
Jevons, Prof. W. S., 211, 257, 335
Jews could not take interest from Jews, 285
Jingoism, 1, 87
Johnson, Samuel, 424
Jones, Robert, 276
Justice after inflations, 283, 329

Kaiser, the ex-, 415
Kennedy, John, 417
Keynes, J. Maynard, 51, 76 n., 311, 354–8, 370–84, 387
King, Gregory, 23, 117
Knapp, Prof. G. F., 398–403

Labour, cosmopolitan interest of, 1–5, 131–2, 163–4; not a curse nor a cost, 14; does not create value, 18; economy of despised, 64; redistribution of, 122–4, 250; versus capital, 164–6
Labour Government (Macdonald's), 363
Labour Party's support of State, 129
Labour saving, 64–5, 121–3
Lambert, Henri, 88–9
Land, quantity of, not to be measured only by area, 312
Landlords, odium cast on, tends to bad housing, 10; interest of, in protection, 44
Lavington, F., 299, 305–7, 315–20
Leaf, Walter, letter to, 361–2
League of Nations and international obligations, 168–77
Lehfeldt, Prof. R. A., 243
Leslie, Prof. R., 243
Leverhulme, Lord, 165
Limitation of currency or credit, 370–84. *See* Currency
Liquor restrictions, 134–5
"Loans make deposits," 263
Luke, Saint, 285

Macculloch, J. R., 424
Macgregor, Prof. D. H., 341–7
Machinery and interest, 291–2
McKenna, Reginald, 45, 63, 265, 362–3
Mackinder, H. J., 46
Mallock, W. H., 279
Mallon, J. J., 166–8
Malthus in favour of population, 72; on prices and subsidies, 143
Marcet, Mrs., 409
Margarine for butter, 166–8
Mark, the gold, will be restored, 347–8, 359–62
Marshall, 32, 268, 276, 335
Marx, 36, 410
Meat, who ate it ? 103–5
Mercantile war to follow military, 54–62
Merchandise Marks law for ex-enemies, 61
Mill, J. S., disfavoured population, 72; defined hoarders, 342
Miller, W. Haig, 263
Mohammedanism, 82
Mobility of labour, more wanted, 410–11
Monetary theory, improvements in, 384–91
Money, more, good for some but not for all, 100–1; value of, to be the great question after the war, 164–6; will be unstable, 166; homogeneity of, 258; power of spending, 378 n.; stocks of, the important thing in regard to prices, 386–7
Monopoly, 38–9
Mun, Thomas, 207

Napoleon, 74, 204
Nation confused with Society, 68
National self-interest, 71; areas unsuitable for self-sufficiency, 129–30; independence means right to carry on war, 132; expenditure, 156–62; Expenditure Committee, 156, 207; "dividend," 268–9
Nationalism in economics, 163

Nearing, Scott, 35–42
Necessaries and luxuries, relative prices of, 32
Necker, 420
Newspapers, 98
Nicholson, Prof. J. Shield, 221–3, 370
North, Dudley, 66

Opulence less important than defence, 269–70
Orwin, C. S., 341

Paper money and prices, 212-18
Paper Pound of 1797–1821, 199–204, 283–4
Parnell, Sir Henry, 276
Peace, terms of, 26; real, or preparation for next war, 49–53; and Plenty, 100
Penjdeh, 87
Pigou, Prof. A. C., 266–75, 371
Poincaré, 356
Political economy suggests order, 49
Political units, advantage of large, 83–8
Population and war, 72, 79–83; and rate of interest, 290–1
Post Office and weighing machines, 64–5. *See* Savings Bank
Postlethwayt, Malachi, 259, 424
Preference, Imperial and also Allied, 58–60
Preparation for next war, 49–53, 58–9, 76, 132
Prices, why some should rise, 16–26; function of rise of, 31; shortage cannot be met by reduction of, 34; committee on, 91–106; inflation and, 107–13; rise of, stultified rise of wages, 136–7; "must be reduced," 141; giving more money raises, 143; control of, 143–4; rise of, not due to scarcity of commodities, 197; Cassel's explanation, 226; level of, to be arrived at, 253–5, 299–307; now raised by additional currency, 324; fluctuated before banks existed, 324
Prodigal son, 184
Productiveness of industry, 181; of taxation, 277
Professors and Protection, 341–7
Profiteer, 92, 98, 105, 113, 116, 141, 142, 143, 195
Profit-making, the alleged failure of, 31–2, 167, 184–6
Profits distribute capital and labour among employments, 250; not popularly explained, 409
Profit-sharing, 411
Progression in taxation, 278–9
Proletariat, the American, bourgeois in character, 411
Propagation directed by Ministers of War and Food or of Propagations, 77, 83
Property, why maintained, 35–42
Protection, 54–62, 341–7; internal, disallowed in French octrois, 70; connexion of, with war, 89, 414; incompatibility of, with exaction of reparations, 362
Providence, no good comes of trust in, 229
Purchasing power, 324, 378, 397

Quantity theory, 371–2, 386–8, 404
Queue system, 101, 148, 159

Railway services, price of, properly raised, 111
Rations, 95, 112, 150
Regeneration expected from the war, 78–9
Reichsbank and Currency Note Account compared, 353–4, 362–4
Reid, G. T., letter to, 11–14
Rent, 38, 312–13
Rentenmark, 359–62
Reparations, 176–7, 302, 320–3, 362, 427–8
Reserve of Currency Notes, 188–90, 193–4, 217

Rhondda, Lord, 158
Ricardo, 36, 38, 115, 326, 332, 424
Ricci, Umberto, 311
Rist, Prof. Ch., letters to, 283-5, 307-9
Robertson, D. H., 299, 306-7
Robertson, J. M., letter to, 91-6
Roman Empire, a small one, 415
Rupee, kept up by limitation of supply, 245

Safeguarding, 54-62, 413
Sankey Coal Commission, 341, 411
Savers, small, how to attract, 46-8
Saving, nature of, 182-3; and taxation, 279; approved by Adam Smith, 425-6
Savings Bank, 46-8, 225, 265, 380
Say, Jean Baptiste, 66
Scott, Sir Walter, 384
Self-interest, national, 71; Adam Smith on, 426-30
Self-sufficiency, national, a bad ideal, 129-31
Seligman, Prof. E. R. A., 299
Service, remuneration according to, 36
Sherman Act, 282
Shopkeepers, 21, 105-6
Sidgwick, Henry, 314
Siege, prices in a, 19-20
Silver coinage, 193-5
Sinking funds, Adam Smith on, 338
Site-value tax, 273-4
Skilled labour, comparative fall of wages for, 138
Sliding-scale, for acquittal of obligations in depreciated currency, 310-11; of wages, 410-11
Slump, the after-war, 131, 230, 328-9
Smart, Prof. William, 152-5
Smith, Adam, 69, 182-3, 269-71, 276-7, 335-40, 344, 411-13, 417-30
Smith, Sir H. Llewellyn, letter to, 107-13
Society, not the nation, 68
Soldiers, in regard to production and income, 45, 269-70
Sound Currency Association, 361
South Africa, 231-49
"Special" deposits, 303-4, 395
Speculation a useful service, 92
Spending money the cause of rising prices, 197, 371-6
Stability, of foreign exchanges or of prices? 354-8, 390, 400-1
Stamp, Sir Josiah, 275-80, 309-11
State, the present, stands for internal peace and external war, 67; more than one, 129; lessened popularity of, 154; larger the better, 83-8
Steuart, Sir James, 419-20
Stewart, W. W., letter to, 332-3
Stocks, Mrs. Mary, 33
Strakosch, Henry, 243-9
Strategic jealousies, 26-9
Submarines, 142-3
Subsidiary coinage, 193-5, 389, 399
Sugar, supply and distribution of, 111, 145-9
Supply and demand, 311-15; in relation to currency, 385-9

Tap, Treasury bills on, 280-1
Taxable capacity, 309-10
Taxation, seldom in itself beneficial, 62; tends to diminish savings, 62; impatience of, 154; actual, compared with borrowing, 160; in relation to income, 271-2; Stamp on, 275-80
Textbooks, doctrine of, on currency, 384
Thales of Miletus, 31
Thompson, Warren S., 79-83
Thornton, Henry, 332
Thumb, old rule of, for bankers, 193
Townsend, Joseph, 82
Trade and war, 88-90
Trade Unions should represent persons and not abstractions,

126 ; a sort of government, 140 ; made stiffer by unemployment insurance, 411
Traffic, what it will bear, meaningless rule, 410
Translation fatal to bad books, 402
Treasury, letter to, 201–4 ; power of, over currency notes, 366–8
Treasury bills, 280–2 ; do not enable banks to force an issue of currency notes, 380–1
Turgot, 420

Unemployment, 97, 133, 319–20, 398, 409, 416
Union of States desirable, 26
Unrest, industrial, 133–52
Unskilled labour, comparative rise of wages for, 138
Usury, 286–7

Vanderbilt, Marshall on services of, 36
Velocity of circulation, 385
Versatility increased by the war, 126
" Vicious circle," 159
Virtue may be practised by business man, 430
Vissering, 326

Wages, harder work as remedy for low, 14 ; real, diminished by the war, 25 ; money, raising of, 158 ; should not be fixed for long periods, 166 ; difficult to reduce, 230 ; variations of, distribute labour, 250–1 ; not to be regulated by aggregate output, 251–2 ; low, and bad farming, 347 ; high, approved by classical economists, 422–4
Waiting, 313–14
Walker, F. A., 384, 417 n.
Wallas, Prof. Graham, 26
War, can be afforded by the wealthy, 1 ; real root of, 26–9, 90 ; paid for out of income, 44–6 ; position of, in economics, 50 ; more power available for, in modern times, 52 ; and population, 79–83 ; raises value of unskilled work, 98 ; slump to follow the, 108–9 ; and commercial policy, 120–33 ; preparation for the next, 132 ; bonuses, 134 ; cost of, 156–62, 336 ; " pity we won it," 298 ; breeds protection, 428
War Savings Certificates, 110, 160
Wealth, Withers on, 77–9 ; dependence of, on labour unrecognised, 100 ; Pigou on, 266–75 ; *per capita*, 420–4
Wheat, minimum price for, 42–4
Whittaker, Sir Thos., letter to, 15–16
Wicksteed, P. H., 411
Wigan houses and paper currency, 210–12
Withers, Hartley, 27–9, 261–5, 382
Witte, 255

Young, Prof. Allyn A., letter to, 28–9

Zollverein, 416

Printed in Great Britain by Butler & Tanner Ltd., Frome and London